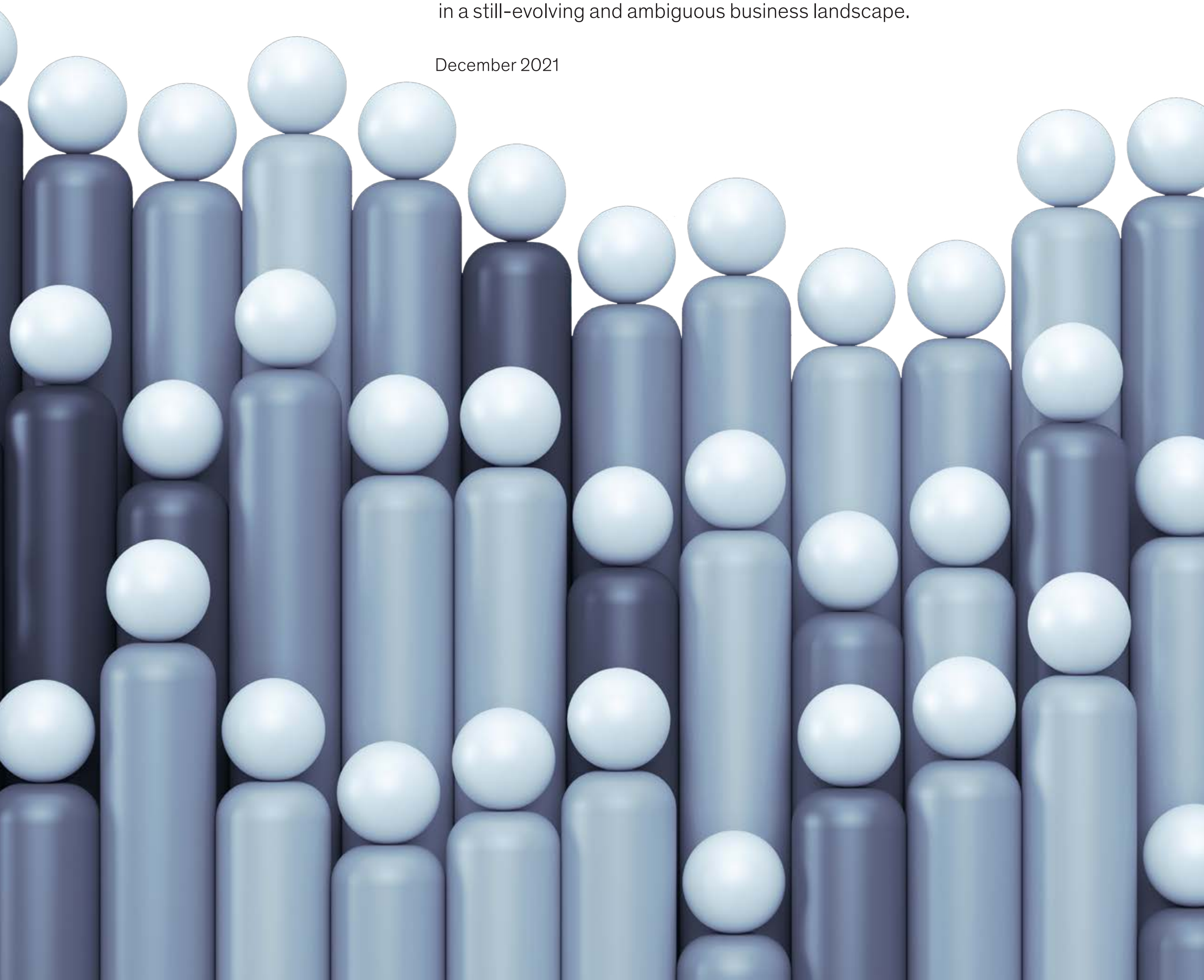
McKinsey & Company

McKinsey Global Surveys, 2021: A year in review

Our collection of research-based insights confirms the countless tests that companies have endured this year—and suggests a way forward in a still-evolving and ambiguous business landscape.

December 2021



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Introduction

It's safe to say that for much of the world, the COVID-19 pandemic's second year did not provide much of a reprieve from the tremendous uncertainty of its first. Yet the demand for a data-driven understanding of the business, economic, and human challenges that unfolded in 2021 continued to hit record highs. Thank you for your interest in McKinsey's global survey research, and we hope the insights that follow prove thought-provoking and useful. We wish you a safe and restful end of the year and a good start to 2022.

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Building workforce skills at scale to thrive during—and after—the COVID-19 crisis

A new survey shows that skill building is becoming common practice, social and emotional skills are in demand, and there's a recipe for successful skill transformations.

by Fabian Billing, Aaron De Smet, Angelika Reich, and Bill Schaninger

In the past year, the COVID-19 pandemic has quickly and dramatically accelerated the need for new workforce skills.[1] The rapid rise of digitization and remote work has placed new demands on employees who, in many instances, now require different skills to support significant changes to how work gets done and to the business priorities their companies are setting. Also required: help from their employers to develop the skills that will make the overall business, and its individual employees, future-ready.

In our newest McKinsey Global Survey on reskilling,[2] the urgency of addressing skill gaps is clear—and, across industries, more important than ever to do. Most respondents say that skill building (more than hiring, contracting, or redeploying employees) is the best way to close those gaps and that they have doubled down on their efforts to reskill or upskill employees since the pandemic began. The results also point to a shift in the most important skills to develop, which tend to be social and emotional in nature: for example, empathy, leadership, and adaptability. But regardless of the skills involved, we also found that there is a clear recipe for success with skill transformations, which are large-scale, programmatic efforts to support skill building so that employees can adapt to fundamentally changing requirements of their current role or move into a new one. When companies follow all nine practices that support a skill transformation—for example, assessing the demand and need for specific skills in the future, designing a portfolio of initiatives to close skill gaps, and launching an organizational structure that is dedicated to learning—the odds for success are nearly guaranteed.

During the pandemic, companies have made a significant shift toward skill building

The survey suggests that the need to address skill gaps is more urgent than ever. A majority of respondents (58 percent) say that closing skill gaps in their companies' workforces has become a higher priority since the pandemic began. And of five key actions to close these gaps—hiring, contracting, redeploying, releasing, and building skills within the current workforce—skill building is more prevalent now than it was in the run-up to the pandemic. Sixty-nine percent of respondents say that their organizations do more skill building now than they did before the COVID-19 crisis (Exhibit 1), a much more dramatic increase than they report for the other four actions. This finding is also consistent with organizations' predictions from our previous survey on skilling before the pandemic began.[3]

Redeploying talent to new roles—which often requires some degree of skill building—has also become more commonplace over the past year. Forty-six percent of respondents report an increase in redeploying talent at their organizations, which makes it the second-most-critical activity for closing skill gaps.

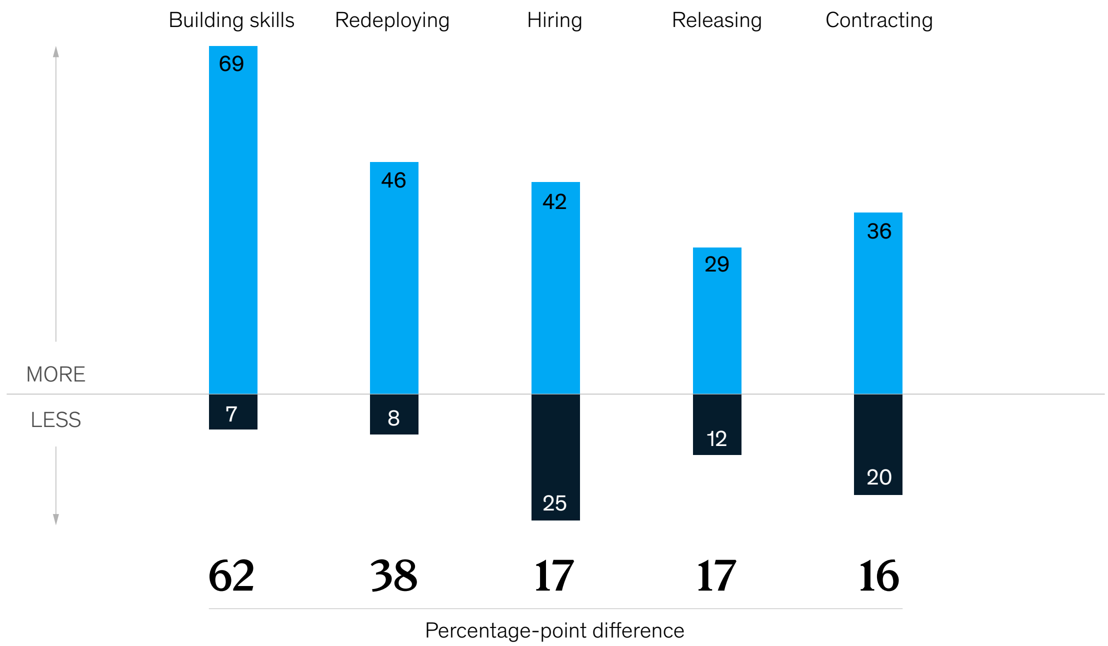
Additionally, the results suggest that this commitment to skill building represents more than a one-time investment. More than half of respondents say that their companies plan to increase their spending on learning and skill building over the next year, compared with their investments since the end of 2019.

[1] For more details on these trends, see Sapana Agrawal, Aaron De Smet, Sébastien Lacroix, and Angelika Reich, "To emerge stronger from the COVID-19 crisis, companies should start reskilling their workforces now," May 7, 2020, McKinsey.com.
[2] The online survey was in the field from December 8 to December 18, 2020, and garnered responses from 700 participants representing the full range of regions, industries, company sizes, functional specialties, and tenures.
[3] This survey was in the field from May 14 to May 24, 2019, and garnered responses from 1,216 participants representing the full range of regions, industries, company sizes, functional specialties, and tenures. For more on the findings, see "Beyond hiring: How companies are reskilling to address talent gaps," February 12, 2020, McKinsey.com.

Exhibit 1

Sixty-nine percent of respondents report an increase in skill building during the pandemic, more so than for other actions to close skill gaps.

Changes in actions used to close skill gaps, since the end of 2019, % of respondents[1]



[1]Respondents who answered "no change" or "don't know" are not shown; n = 700.

Skill building is more prevalent than it was prior to the pandemic, with 69 percent of organizations doing more skill building now than they did before the COVID-19 crisis.

Skill-building efforts have focused on ‘softer’ and advanced cognitive skills

The survey asked about 25 specific skills that companies have prioritized to address through reskilling, and more than half of respondents report a focus on developing leadership, critical-thinking and decision-making, and project-management skills. Compared with the results from 2019, many of the skills where respondents report the biggest increases in focus fall into two categories: social and emotional skills (which account for three of the five biggest increases) and advanced cognitive skills (Exhibit 2). For example, the share saying that their companies are addressing interpersonal skills and empathy skills has nearly doubled in the past year.

Basic digital skills have also become a clear priority for companies since the pandemic began; the share saying so is 16 percentage points larger than in 2019. There are also some industry differences of note: in advanced industries[4] and industrial organizations,[5] respondents report less of a focus than others on building basic digital skills—likely because these skills were already present before the pandemic. But these respondents are much likelier than others to prioritize technology design, engineering, and maintenance: 50 percent say so, while 15 to 28 percent of respondents in all other industries say the same. On the other hand, their peers in the public and social sectors, as well as in healthcare and pharmaceuticals, are nearly twice as likely as those in industrial organizations to say that they have focused on interpersonal skills and empathy.

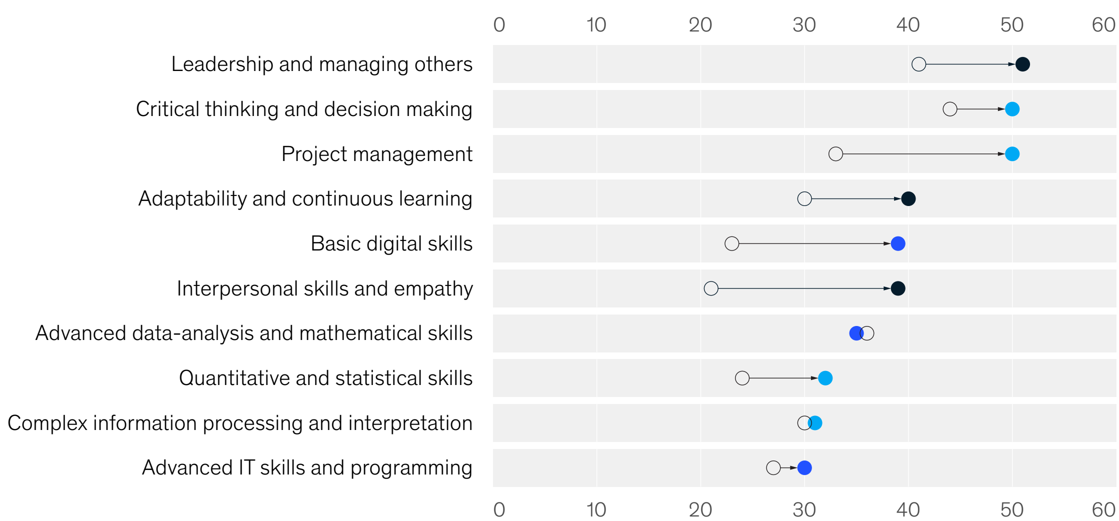
[4] Includes respondents in the advanced-electronics, aerospace and defense, automotive and assembly, and high-tech industries.
[5] Includes respondents in the agriculture, chemicals, electric power and natural gas, metals and mining, oil and gas, and paper and forest products industries.

Exhibit 2

Most of the skills that companies are increasingly focused on developing are social, emotional, and advanced cognitive.

Skills that companies have prioritized to address through reskilling,[1] % of respondents

Social and emotional skills · Advanced cognitive skills · Technological skills · 2019 → 2020



[1] Out of 25 skills that were offered as answer choices; n = 700.

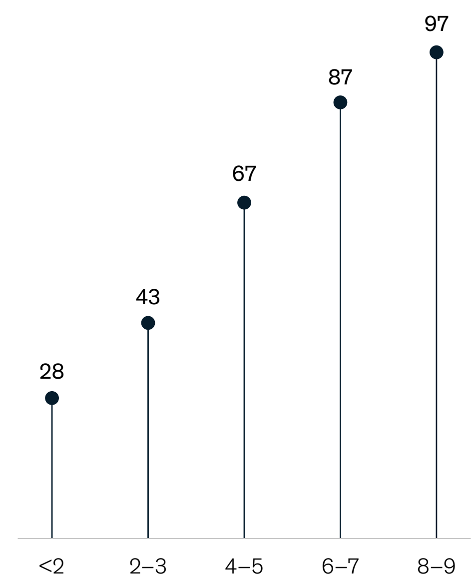
Getting skill transformations right: The recipe for success

Even before the pandemic, respondents recognized that skill gaps were a pressing and critical issue. And while the previous survey indicated that skilling programs were at an early stage in 2019, companies appear to have made real progress. Fully half of respondents now say that their organizations have begun a skill transformation[6] to support employees' skill building in a large-scale and programmatic way. For those that have, the benefits are clear. Between 71 and 90 percent say their skill transformations have had a positive impact on four company outcomes: the ability to realize company strategy, employees' performance and satisfaction, and reputation as an employer. Furthermore, reskilling pays off. In other research, we learned that reskilling yields positive economic returns for UK employers, in addition to other benefits: for example, increased productivity and improved employee morale.[7] Despite the enthusiasm, the successful design and implementation of skill transformations is difficult to get right—and, in our experience, relies on nine key practices that all need to be applied properly. Based on our research, the more of these nine practices a company pursues, the higher its overall likelihood of an effective transformation (Exhibit 3).

Exhibit 3

The likelihood of a successful skill transformation increases dramatically when companies pursue more of nine key practices.

Success rate of skill transformations,[1] by number of practices successfully implemented (out of 9), % of respondents (n = 700)



[1]Respondents who agree that (a) their organizations can effectively reskill and/or upskill their workforces so that they are ready for future changes in the business environment, and (b) they have a culture that supports learning and development.

The nine practices support three different phases of a skill transformation (Exhibit 4). The first phase (which we call "Scout") consists of rapid workforce planning to identify skill gaps, which involves comparing the company's current supply of skills with the demand for certain skills, based on its strategic ambition, digital agenda, and overall business model.

The second phase ("Shape") focuses on how companies shape the skill strategy to close anticipated gaps, by finding the right mix of actions (that is, building skills as well as redeploying, hiring, contracting, and releasing employees). Since skill building and redeployment are often the predominant actions that companies are taking, important decisions in this phase also include which learning formats to use, how to design and deliver learning journeys to employees, and the setup of required infrastructure (for example, learning-management systems) and governance for learning.

The third phase ("Shift") involves the execution and delivery of skill-building efforts at scale, across the organization: ensuring that the workforce is building new skills, that there are dedicated organizational structures in place for learning (for example, skilling hubs), and that there is a rigorous yet dynamic system for tracking the impact of learning.

The results indicate that all nine of these practices are important—there are no shortcuts to take. At

[6] That is, a large-scale and programmatic effort to support employees' skill building so that they can adapt to the fundamentally changing requirements of their current role or move into a new one.
[7] Tera Allas, Will Fairbairn, and Elizabeth Foote, "The economic case for reskilling in the UK: How employers can thrive by boosting workers' skills," November 16, 2020, McKinsey.com.

Exhibit 4

The nine key practices support three different phases of a skill transformation.

% of respondents who say their companies have successfully implemented each practice

Scout: **Workforce planning to assess potential skill gaps**	
Assessing demand and/or need for specific skills in the future	58
Determining the current supply of specific skills	56
Analyzing skill gaps (including development of the business case to close them)	54
Shape: **Development of a skill strategy to ensure that the workforce is future-ready**	
Designing a portfolio of initiatives to close skill gaps	43
Designing tailored learning journeys and delivery plans for specific roles and/or groups of employees	40
Deciding on learning infrastructure and enablers[1]	48
Shift: **Reimagined infrastructure for skilling at scale**	
Launching a "skilling hub" or other organizational structure[2] dedicated to learning	28
Delivering a skill transformation at scale across the organization via comprehensive capability-building programs that address the most critical skill needs	28
Implementing dynamic tracking of workforce and impact[3]	23

[1]That is, specific technologies to use.
[2]For example, that conducts skill and fit assessments, matches talent to new roles, and redeploys people accordingly.
[3]For example, return on investment and impact on business outcomes.

At the organizations that have implemented all nine practices, respondents report a nearly 100 percent chance of having a successful skill transformation.

the organizations that have implemented all of them, respondents report a nearly 100 percent chance of having a successful skill transformation,[8] which is 2.5 times higher than the success rate for organizations that have failed to implement at least one of the practices (Exhibit 5).

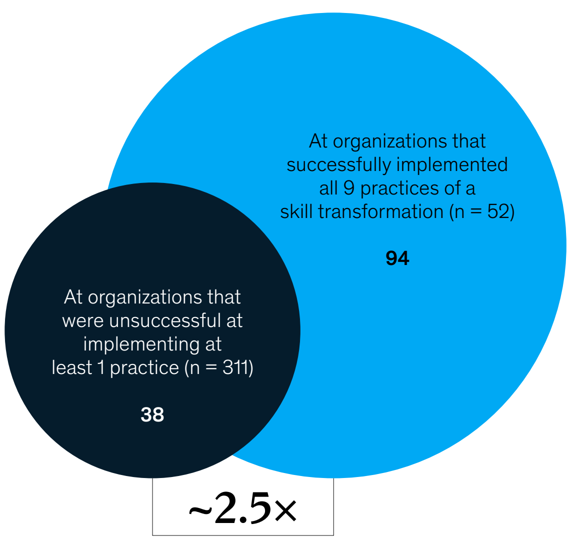
While all nine matter, it is also true that some practices are implemented successfully more often than others. According to respondents, companies tend to be most successful at the three practices related to workforce planning and assessment: assessing demand and need for specific skills in the future (which 56 percent say their companies do well), determining the current supply of skills (56 percent), and analyzing skill gaps (54 percent). Smaller organizations are particularly good at workforce-planning practices, seemingly because they often benefit from greater transparency around the organization's needs, know their employees better, and can create a more accurate baseline of skills. Smaller organizations also see a higher success rate at skilling than their larger counterparts, consistent with the findings from 2019.

On the other hand, companies appear to struggle most with the practices related to the infrastructure and delivery of skilling efforts. For instance, just 23 percent of all respondents whose companies have started a skill transformation say that they have implemented dynamic tracking of the workforce's performance and overall impact on the business. But it is critical to perform each of these practices to reap the full benefits of a skill transformation.

Exhibit 5

Effectively implementing the nine key practices nearly guarantees a successful skill transformation.

% of respondents reporting success in skill transformations[1]



[1]Respondents who agree that (a) their organizations can effectively reskill and/or upskill their workforces so that they are ready for future changes in the business environment, and (b) they have a culture that supports learning and development.

When building skills, go beyond digital learning and apply a mix of formats

Digital learning feels ubiquitous, especially during the pandemic. And the survey results suggest that it works: respondents who say that digital learning is suitable for their employees, or who say the same for sessions that combine in-person and virtual learning, report a higher overall rate of success for their companies' skill transformations.[9]

But the survey also indicates that, overall, a varied and multichannel approach to learning and skill building works best (Exhibit 6). Out of 12 learning formats, respondents say that an average of five formats are suitable for their companies' employees. At the companies that have already begun skilling transformations (reported by half of all respondents), the rate of success is higher when respondents cite a larger number of learning formats: it is 50 percent for those who identify fewer than four formats, and more than 70 percent for those who cite eight or more.

According to the results, other less common ways to learn also link to success. Respondents who cite peer learning teams or expert coaching are likelier to

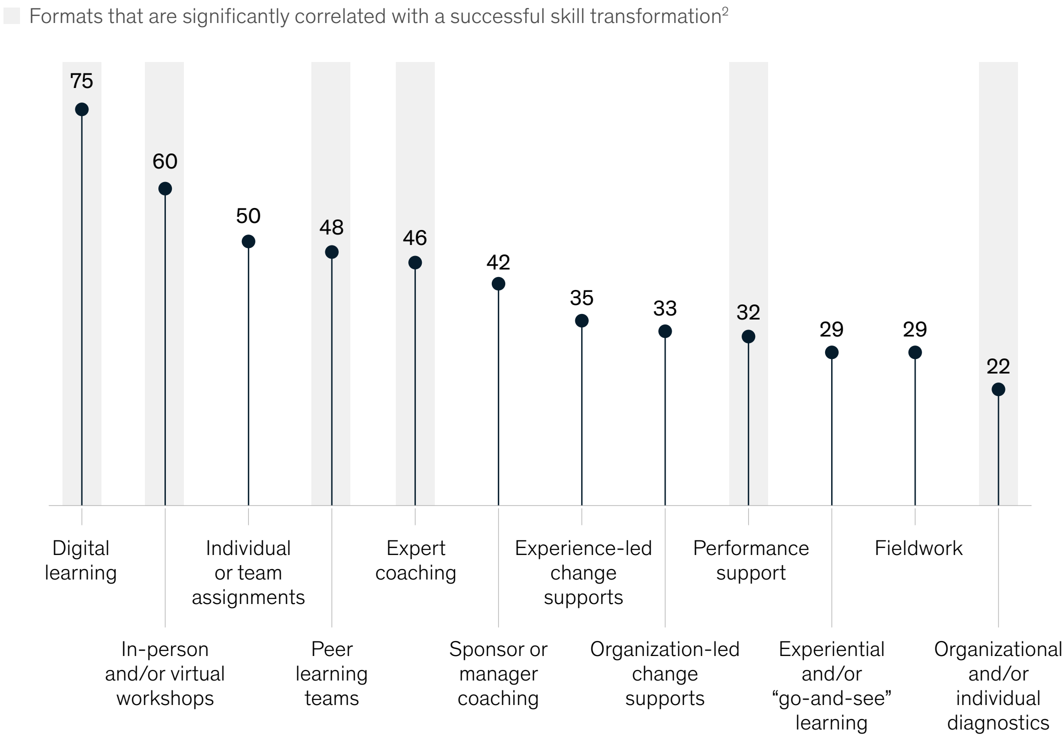
[8] We define organizations with successful transformations as those that, according to respondents, can effectively reskill their workforce, upskill it, or both so that it is ready for future changes in the business environment, and those that have a culture that supports learning and development.

[9] For more on our research about learning programs, see "Rethink capabilities to emerge stronger from COVID-19," November 23, 2020, McKinsey.com.

Exhibit 6

While digital learning is the most suitable format for skill building, the survey suggests that a multichannel approach supports success.

Most suitable learning/skill-building formats for organization's employees,[1] % of respondents



[1]Respondents who answered "other" or "don't know" are not shown; n = 700.
[2]Confidence interval = 0.95.

report successful transformations, which underlines the importance of the team-based learning that, in our experience, is a crucial ingredient in successful skilling strategies.

Many companies are now at a critical juncture when it comes to talent development and skill building, and it is clear from the survey results that dramatic changes are needed to thrive—or even survive—in the future. To emerge stronger from the pandemic, now is the time for organizations to invest in skill transformations and apply the lessons of the past year to crystallize their current and future skill needs. The survey confirms that organizations must take a holistic approach to skill transformations and focus on all nine of the practices that we know support success; there are no shortcuts to take. And when they do so, they should not fall into the trap of focusing only on "hard" technological skills or digital-only channels for learning. The pandemic, and our research, has shown how critical interpersonal skills and resilience really are, and that they require different ways of learning to be cultivated.

The survey content and analysis were developed by **Fabian Billing,** a senior partner in McKinsey's Düsseldorf office; **Aaron De Smet,** a senior partner in the New Jersey office; **Angelika Reich,** a partner in the Vienna office; and **Bill Schaninger,** a senior partner in the Philadelphia office.

The authors wish to thank Jutta Bodem-Schrötgens, Nicole de Locarnini, and Pawel Poplawski for their contributions to this article.

Three keys to building a more skilled postpandemic workforce

Many companies face large, and growing, skills deficits. A few companies approach skill building in a more integrated way—and are quietly gaining an edge on rivals.

by Jutta Bodem-Schrötgens, Angelika Reich, Bill Schaninger, and Kartik Sharma

The COVID-19 crisis and subsequent move to hybrid working models have accelerated the need for new workforce skills. Fifty-eight percent of respondents to our recent global survey[1] said that closing skills gaps has become a higher priority since the pandemic began, and 69 percent said their companies engage in more skill building than they did before the crisis.

Intriguingly, the skills companies prioritize most are leadership and managing others, critical thinking and decision making, and project management (Exhibit 1). This suggests that in addition to wanting to be more employee centric, organizations are still coming to grips with the new ways of working forced on them by the virus.

The challenges will only grow. For example, we estimate that demand for social and emotional skills (ones that machines can't master) will increase 25 percent in the United States alone over the next decade, compared with a previously expected rise of 18 percent (see sidebar, "A software company gets emotional"). And research[2] from the McKinsey Global Institute finds that 107 million workers may need to switch occupations by 2030—up 12 million from a prepandemic estimate.

Companies need to prepare their people for a future where new and evolving skills and ways of working are a given and where an embrace of continuous learning[3] is the key to relevancy in the workplace. And leaders must do this while embarking on the broader organizational experiment of determining what the workplace even looks like in a post-COVID-19 world.

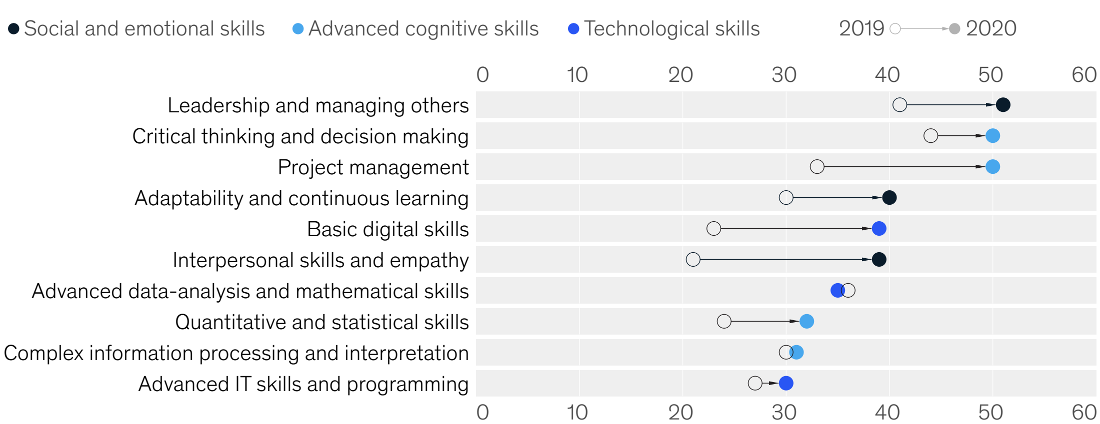
To help, senior executives can study the practices of organizations that already take workplace skilling seriously. In this article, we highlight three nascent principles drawn from best practices. While relatively few companies have fully mastered the challenges,

[1] "Building workforce skills at scale to thrive during—and after—the COVID-19 crisis," McKinsey Global Survey results, April 30, 2021, McKinsey.com.
[2] "The future of work after COVID-19," McKinsey Global Institute, February 18, 2021, McKinsey.com.
[3] "Building a learning culture that drives business forward," April 16, 2021, McKinsey.com.

Exhibit 1

Companies are increasingly focused on developing social, emotional, and advanced cognitive skills.

Skills that companies have prioritized to address through reskilling,[1] % of respondents



[1]Out of 25 skills that were offered as answer choices; n = 700.

A software company gets emotional

The development of so-called "soft" skills is easy to overlook in a company's push to gain technological know-how. Not so for a global software company. When company leaders recognized how cloud computing would make its future sales more dependent on long-term customer relationships, it upskilled 30 percent of its client-facing staff to ensure they would have the interpersonal and emotioal skills they would need. The effort has helped the company stay close to customers but is far from over. Requirements for upskilling are increasing again in the software industry as its "skills life cycle" has shortened, a result of technological change and bruising competition.

their examples can serve as useful touchpoints for any organization aspiring to start building its own more resilient, future-ready workforce.

1. Find your true starting point

Leaders at a large insurance company knew they faced a skills deficit. Prior to the pandemic the company was losing top recruits to sexier high-tech firms. Now, with AI and data analytics skills becoming even more important to the industry, company leaders suspected their current workforce was falling behind. But where, how far, and how fast? "We have more than a hundred job families and two thousand-plus different types of roles," noted one executive. "Where do we start?"

In response, the company took a comprehensive inventory of skills across the organization. The inventory was validated by a combination of human managers and AI, which allowed for an apples-to-apples comparison of people's résumé inputs, as well as their professional experience and accomplishments.

Importantly, the exercise wasn't treated as a cataloguing of roles. Collecting job titles is a waste of time when what's changing are the underlying skills. Similarly, the insurance company didn't approach the effort as a one-off project but as part of a commitment to a new approach—one grounded in the principle of linking talent to a clearly defined value agenda. The inventory was to be part of the fact base supporting an enterprise-wide supply-and-demand model for current and future roles.

The first test of the database came when the insurer used it to zero in on 15 job families whose skills would be most vital for the company's long-term success. In parallel, the company used it to pinpoint areas of immediate concern. For example, the company saw it would face big head-count shortfalls for data analysts, systems developers, and IT-infrastructure experts—all roles in which the underlying skills were themselves changing the fastest.

2. Make skill building a way of life

As the insurance company's talent aspirations took shape, the organization created a "skills hub" to manage, operationalize, and scale them.

The hub, a permanent business unit led by the company's head of talent, became responsible for balancing the supply and demand of skills—for instance by creating foundational learning programs for everyone, as well as customized programs for reskilling people in particular roles.

As a pilot exercise, the hub started with the company's finance and call-center units—two important groups in which technology already threatened to make many skills (and roles) redundant. In areas where roles needed to change, the hub offered learning modules to help employees gain necessary skills; when roles were being eliminated, the hub provided upskilling to help people qualify for a different role or to find adjacent roles where

By making clear to everyone that the reskilling was an investment in talent, and in direct support of the company's regional growth plans, employees were more energized.

possible. Senior executives had feared they would have to resort to widespread layoffs or severance offers, but the hub ultimately redeployed or reskilled nearly everyone in the pilot units.

Similarly, a large telecom company had a high success rate using its skills hub to reskill and redeploy employees whose roles were being affected by technology. The company's rationale helped. By making clear to everyone that the reskilling was an investment in talent, and in direct support of the company's regional growth plans, employees were more energized (and reassured the program wasn't simply a cost-cutting move). Nonetheless, the company's efforts made financial sense as well. In our experience, hiring new workers can be more than twice as expensive as upskilling and reskilling existing employees.

To be most effective, skills hubs should have a clear remit. This should include candidate assessment, the future allocation of roles, the implementation of the program itself, and the measurement of impact (Exhibit 2).

3. Take an ecosystem view

During the chaotic early days of the COVID-19 crisis, some companies, out of necessity, adopted an ecosystem mindset. In just two days, for example, Dubai-based Majid Al Futtaim reskilled one thousand employees from its cinema business to work in its grocery business.[4] Similarly, HR technology company Eightfold.ai, together with the US-based Food Industry Association (FMI), created a talent exchange to help furloughed and laid-off workers find open jobs in other member companies.[5] The exchange ultimately amassed more than one million job openings, while providing workers access to 700 free courses to help them upskill.

More recently, the European Round Table for Industry launched a pan-European training initiative to help unemployed and at-risk workers. Dubbed Reskilling 4 Employment, the effort aims to reskill one million workers by 2025, and up to five million by 2030. Initial pilot projects are planned in Portugal, Spain, and Sweden, and corporate supporters include AstraZeneca, Iberdrola, Nestlé, SAP, Sonae, and Volvo Group.[6]

As these examples suggest, integrating skill building with the whole ecosystem in mind can help companies as well as communities and other stakeholders. Cisco's Networking Academy offers a good example of just such a win–win approach. The company partners with educators and instructors around the world to offer students IT training in a range of areas such as big data, cloud, cybersecurity, and machine learning. The effort connects students

[4] "Stay visible—but don't be needed: How Alain Bejjani is leading through the unexpected," *McKinsey Quarterly*, August 3, 2020, McKinsey.com.
[5] "Eightfold.ai creates talent exchange with FMI to immediately match recently furloughed or laid off employees with critical open jobs," FMI, April 6, 2020, fmi.org.
[6] "ERT announces new initiative to stimulate reskilling and boost human capital in the EU," European Round Table for Industry, May 7, 2021, ert.eu.

Exhibit 2

Creating a skills hub can help companies in four ways.

Assess candidates

- Collects all key skills and roles
- Ensures fairness and transparency
- Bases criteria selection on tailored assessment

Assess future needs

- Collects supply-and-demand data and assesses priorities
- Anticipates timing of skill needs relative to availability of talent (and company's ability to reskill)

Manage skill building

- Designs, manages, and implements learning journeys
- Maintains an overview while managing the project
- Shares best practices across a common learning platform

Measure the impact

- Creates dashboards to manage the process and track the program
- Creates ongoing view of supply and demand of skills

to jobs inside Cisco and with its external partners, while creating a much larger pool of skills the company prioritizes.

Companies are more likely to gain an edge in skill building when their leaders are willing to question old assumptions. Legacy approaches are likely to be too slow, too incremental, or too difficult to scale given the challenges ahead.

Organizations must also be willing to question their legacy mindsets, including presumptions of what employees want and what they're capable of. Employees are often more energized by skills development than senior executives give them credit for. This was true at a midsize European bank, where leaders worried that tellers would be unmotivated by the company's reskilling program, or even resent it. But rather than balk at the changes, the tellers embraced them, and the bank ultimately created three distinct career paths for the tellers as part of its successful pilot program—one that is now being scaled across the entire organization.

Jutta Bodem-Schrötgens is a consultant in McKinsey's Hamburg office, **Angelika Reich** is a partner in the Vienna office, **Bill Schaninger** is a senior partner in the Philadelphia office, and **Kartik Sharma** is an expert in the Waltham, Massachusetts, office.

The authors wish to thank Tomi Eisenberg for her contributions to this article.

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How companies capture the value of sustainability: Survey findings

What makes the difference between a sustainability program that produces business value and one that doesn't? A new survey identifies practices that distinguish value-creating companies from others.

Amid widening recognition of how environmental issues such as climate change create business opportunities and risks, results from a McKinsey Global Survey[1] show that companies that generate value from their sustainability programs follow a distinctive set of management practices. Survey respondents say these companies are more likely than others to make sustainability a strategic priority and to set out specific aspirations and targets. Responses also suggest that value-creating companies are more likely than others to make sustainability an element of their corporate culture and train employees on how to integrate sustainability into their work.

Survey results indicate that value-creating companies are more apt to engage customers and business partners in their sustainability agendas. Compared with those at other companies, more respondents from value-creating companies say they collaborate with customers and suppliers on addressing sustainability issues, adjust product portfolios to be more sustainable, and account for sustainability factors when selecting and evaluating suppliers. Respondents from value creators are also more likely than others to report that sustainability issues inform how their company manages its facilities and its transportation networks.

Looking five years ahead, about two in five respondents to our survey say they expect their companies to generate value from sustainability. Understanding the distinctive practices of today's value-creating companies could help others find a way to join their ranks.

An optimistic outlook

Sustainability endeavors often make good business sense, promising to deliver revenue gains, cost savings, and other benefits that lift enterprise value. In our survey, 22 percent of respondents—the value-creating group that this article focuses on—say their companies realized modest or significant value from sustainability in the past five years. Nearly as many respondents say their companies' sustainability programs resulted in significant or moderate cost increases. About one-third say their companies' sustainability programs have had minimal or no financial impact.

Respondents are also optimistic that their companies' sustainability programs will yield value in the future. Compared with the proportion who say these programs have already created value, nearly twice as many respondents, or 40 percent, say they expect the programs to generate modest or significant value in the next five years (Exhibit 1). Respondents in a few

[1] The online survey was in the field from January 21 to January 31, 2020, and garnered responses from 2,475 participants representing the full range of regions, industries, company sizes, functional specialties, and tenures.

Survey results suggest that to catch up with the value creators, other companies might start by understanding which practices are most closely linked with positive financial impact.

specific industries are especially likely to predict that their companies will create value from sustainability during that five-year timeframe. These industries include some—such as automotive; electric power and natural gas; oil and gas; and travel, transport, and logistics—that play pivotal roles in curbing climate change.

Strategic, purposeful intent

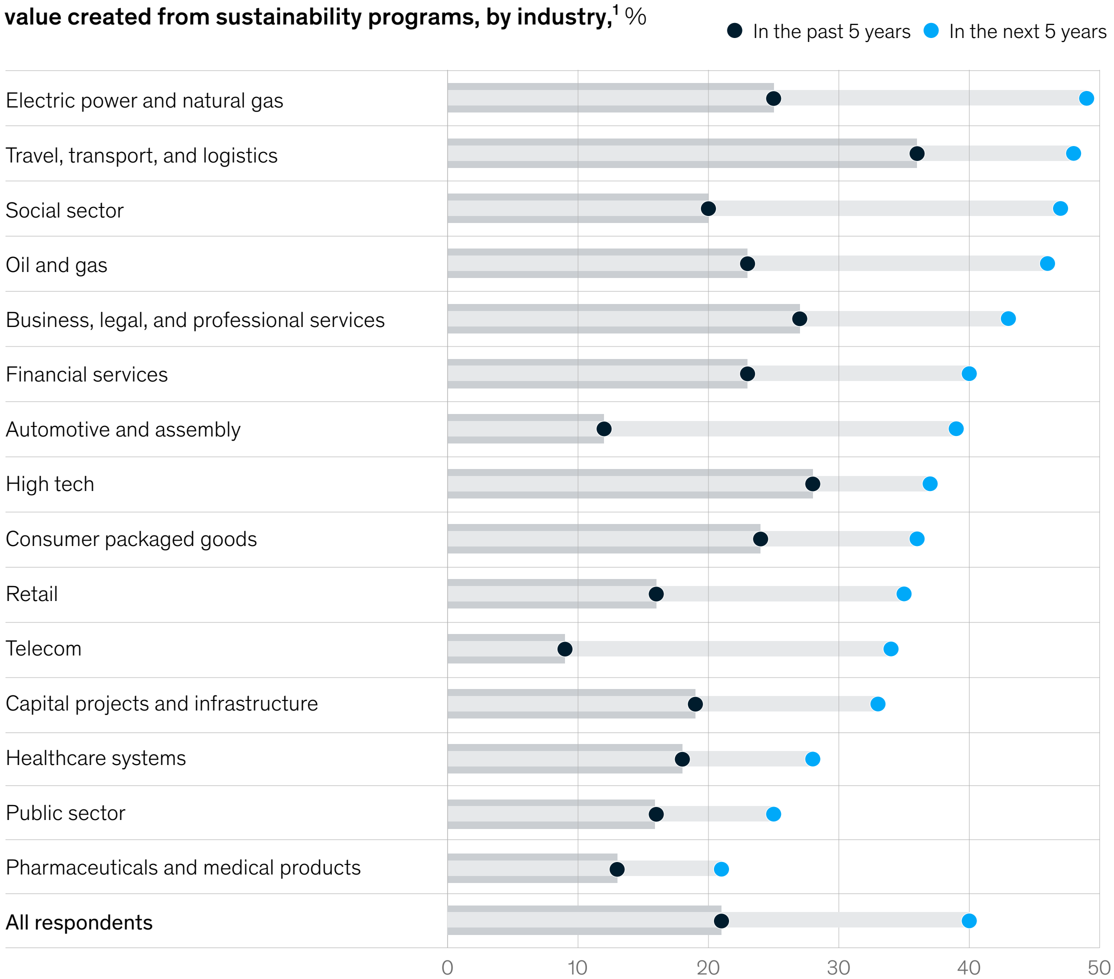
Survey results suggest that to catch up with the value creators, other companies might start by understanding which practices are most closely linked with positive financial impact. According to respondents, value creators exhibit a strategic, purposeful approach that differs from that of other companies in several ways. More than half of respondents at value creators say their company's CEO makes sustainability a priority on the strategic agenda—a significantly greater proportion of respondents than among nonvalue-creating companies (39 percent).

Motives for engaging on sustainability also appear to matter. Respondents at value creators are significantly more likely to say their organizations address sustainability topics to fulfill their

Exhibit 1

Forty percent of respondents expect company sustainability programs to generate value in the next five years—nearly double the current share.

Share of respondents who report or expect 'modest' or 'significant' value created from sustainability programs, by industry,[1] %



[1]Total 7 answer choices presented: "significant cost," "modest cost," "minimal to no cost or value," "modest value," "significant value," and "don't know"; n = 2,421. Only industries that received meaningful numbers of responses are shown.

organizational purpose—to align with their goals, mission, or values, or to make a tangible, positive impact on an issue (Exhibit 2). Respondents at other companies, on the other hand, are significantly more likely to say that these organizations are addressing sustainability for other reasons, such as to meet industry norms or standards or to conform with regulatory requirements.

Sharp focus

When it comes to implementing sustainability strategies, value creators place more importance than other companies do on translating the sustainability strategy into definite terms: value creators are significantly more likely to establish clear and focused priorities, set targets or goals, and develop key performance indicators for sustainability (Exhibit 3).

Exhibit 2

Companies creating value with sustainability are more likely than others to address the issue for reasons related to their organizational purpose.

Organization's reasons for addressing sustainability topics,[1] % of respondents

[1]All 13 topics that were presented as answer choices. Responses with "don't know," "other," and "not applicable" are not shown here. Total n = 2,475.

Exhibit 3

Value creators are more likely than others to have sustainability programs with clear priorities, defined targets, and key performance indicators.

Features of the organization's sustainability program,[1] % of respondents

[1]All categories shown here represent statistically significant differences between companies that create value from sustainability and those that don't; n = 2,421.

Engaging employees

According to respondents, another noteworthy difference between companies that create value from sustainability and those that don't is that value creators are doing more to engage their workforces in sustainability efforts (Exhibit 4). Nearly three-fifths of respondents at value creators say that sustainability is a part of the corporate culture. A significantly lesser share of respondents at other companies, 39 percent, say the same.

Among the value creators, employee engagement is also a more important element of the sustainability agenda than it is for other companies. A greater share of respondents at value creators say that all employees receive training on integrating sustainability practices into their work and that employees understand how sustainability efforts align with the company's strategy. Incentives are another factor: a greater share of respondents at value creators say their organizations consider sustainability performance to a moderate or significant extent when making decisions about employees' compensation.

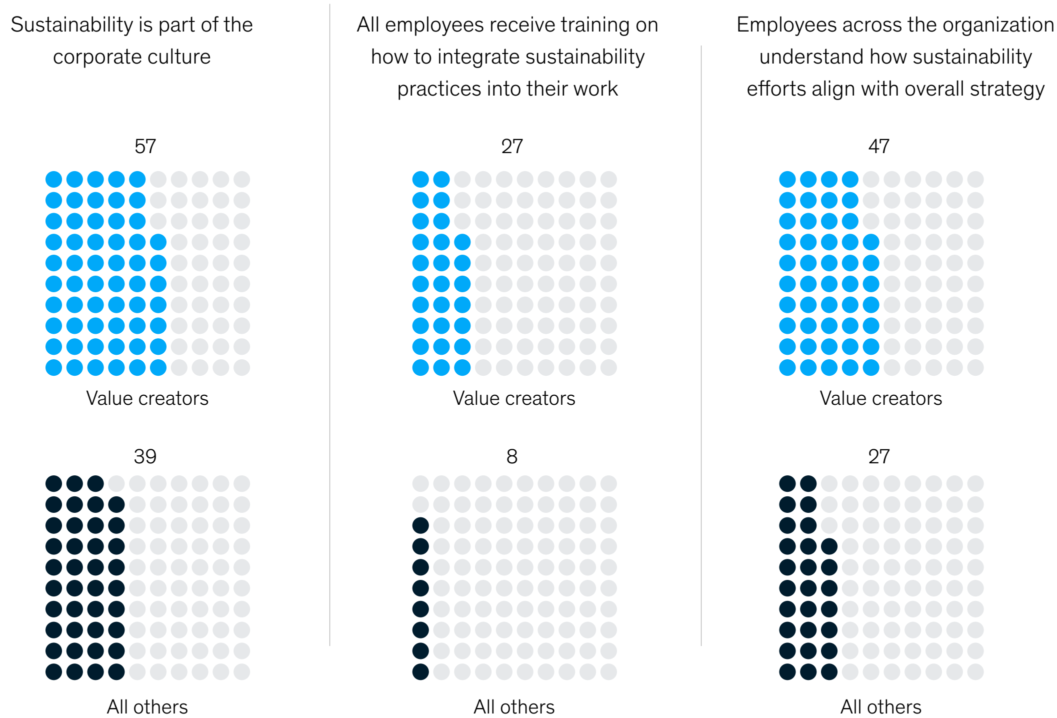
Meeting customer expectations

Just as value creators engage employees in their sustainability programs, they also put more effort than other companies into understanding customers' expectations and respond with changes to their products (Exhibit 5). Disproportionate shares of value creators seek customer input on the sustainability attributes of their products and services and highlight those attributes in their marketing efforts. Their orientation toward sustainability issues in customer relations extends

Exhibit 4

Sustainability is a more significant element of corporate culture and employee engagement at value-creating companies than at others.

Cultural and workforce aspects of the organization's sustainability program,[1] % of respondents



[1]All categories shown here represent statistically significant differences between companies that create value from sustainability and those that don't; n = 2,421.

Just as value creators engage employees in their sustainability programs, they also put more effort than other companies into understanding customers' expectations and respond with changes to their products.

to the management of product portfolios: value creators are more likely than other companies to change product designs, develop new product-as-a-service models to address sustainability issues, and offer sustainable brands.

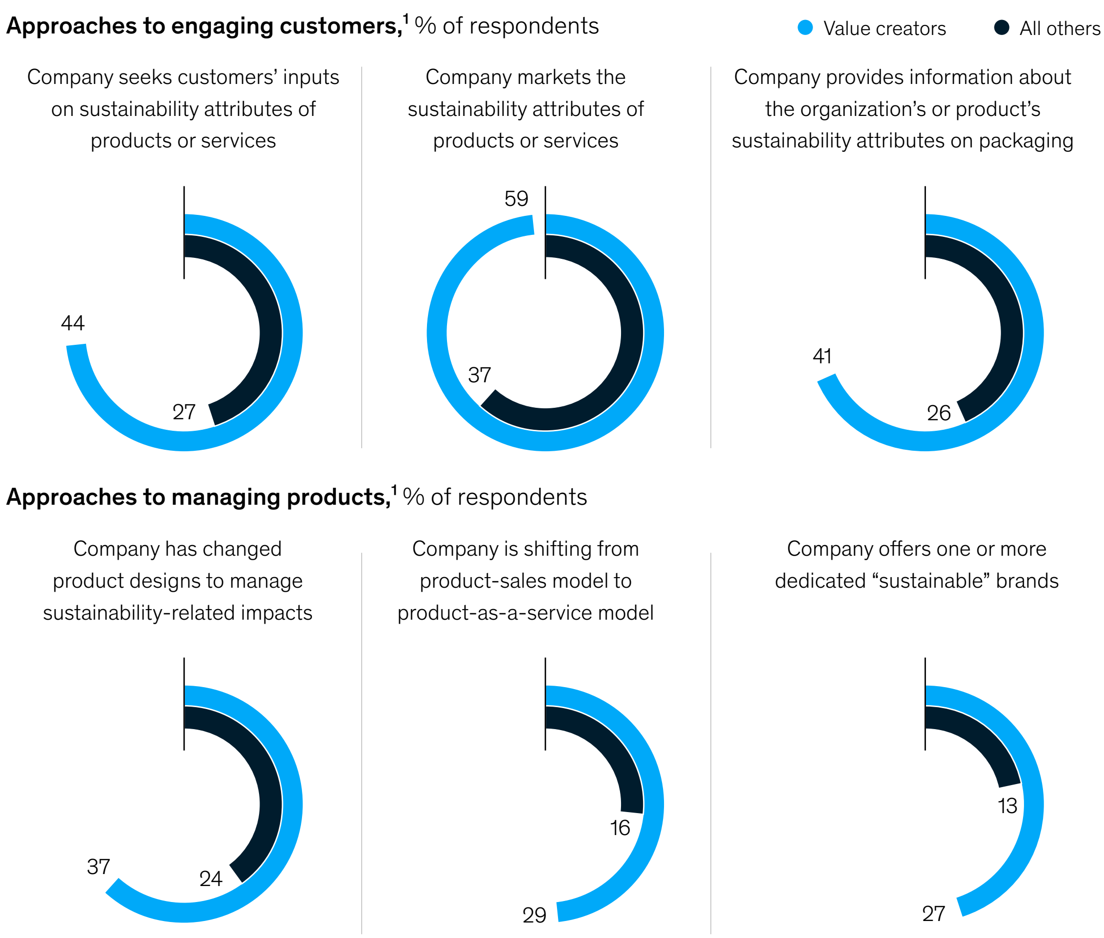
Value-chain collaboration

For most companies, the majority of sustainability impacts result from the activities of their suppliers, contract manufacturers, distributors, and other value-chain partners. Value-chain engagement can thus be a telling indication of how much companies are doing about sustainability—and it's an area where value-creation leaders demonstrate distinctive approaches (Exhibit 6).

Value-creation leaders are more likely than others to make sustainability a priority in managing energy, water use, and waste generation at their own facilities, as well as making decisions about their site portfolios. They're also more likely to collaborate with and monitor suppliers' sustainability performance and to seek improvements in the efficiency of their transportation and distribution networks.

Exhibit 5

It's more common for value creators than for others to engage customers on sustainability attributes and update product offerings in response.

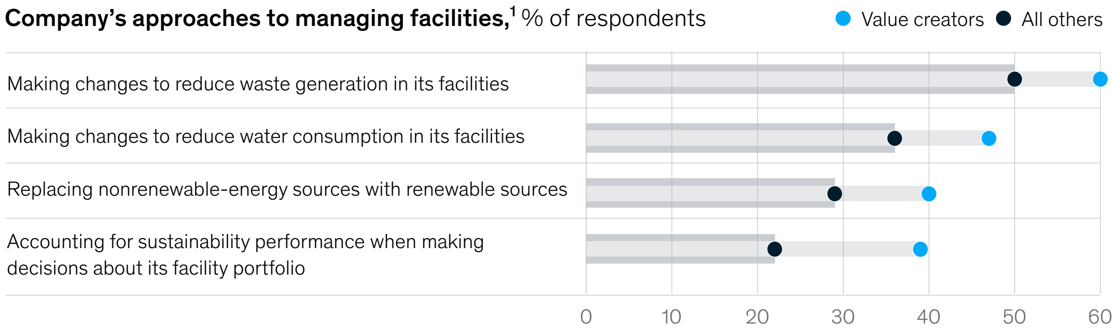


[1]All categories shown here represent statistically significant differences between companies that create value from sustainability and those that don't; n = 2,421.

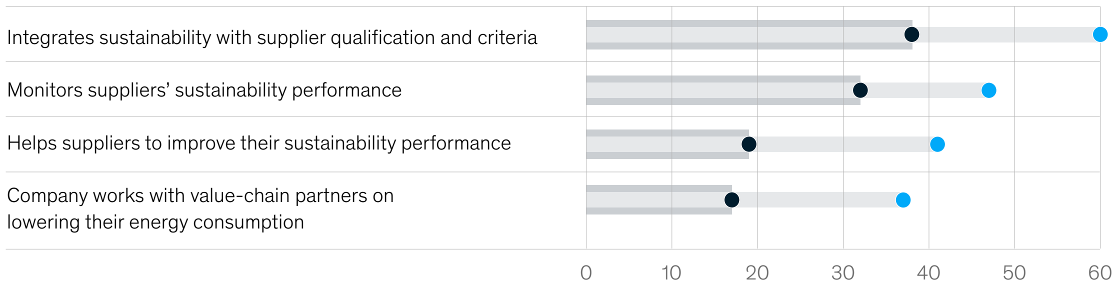
Exhibit 6

Collaboration with the value chain distinguishes value creators' sustainability programs from those of other companies.

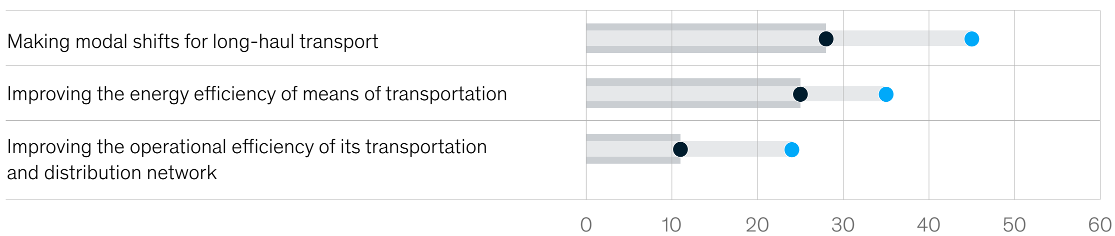
Company's approaches to managing facilities,[1] % of respondents



Company's approaches to working with suppliers and value-chain partners,[1] % of respondents



Company's approaches to managing transportation and distribution networks,[1] % of respondents



[1]All categories shown here represent statistically significant differences between companies that create value from sustainability and those that don't; n = 2,421.

Looking ahead

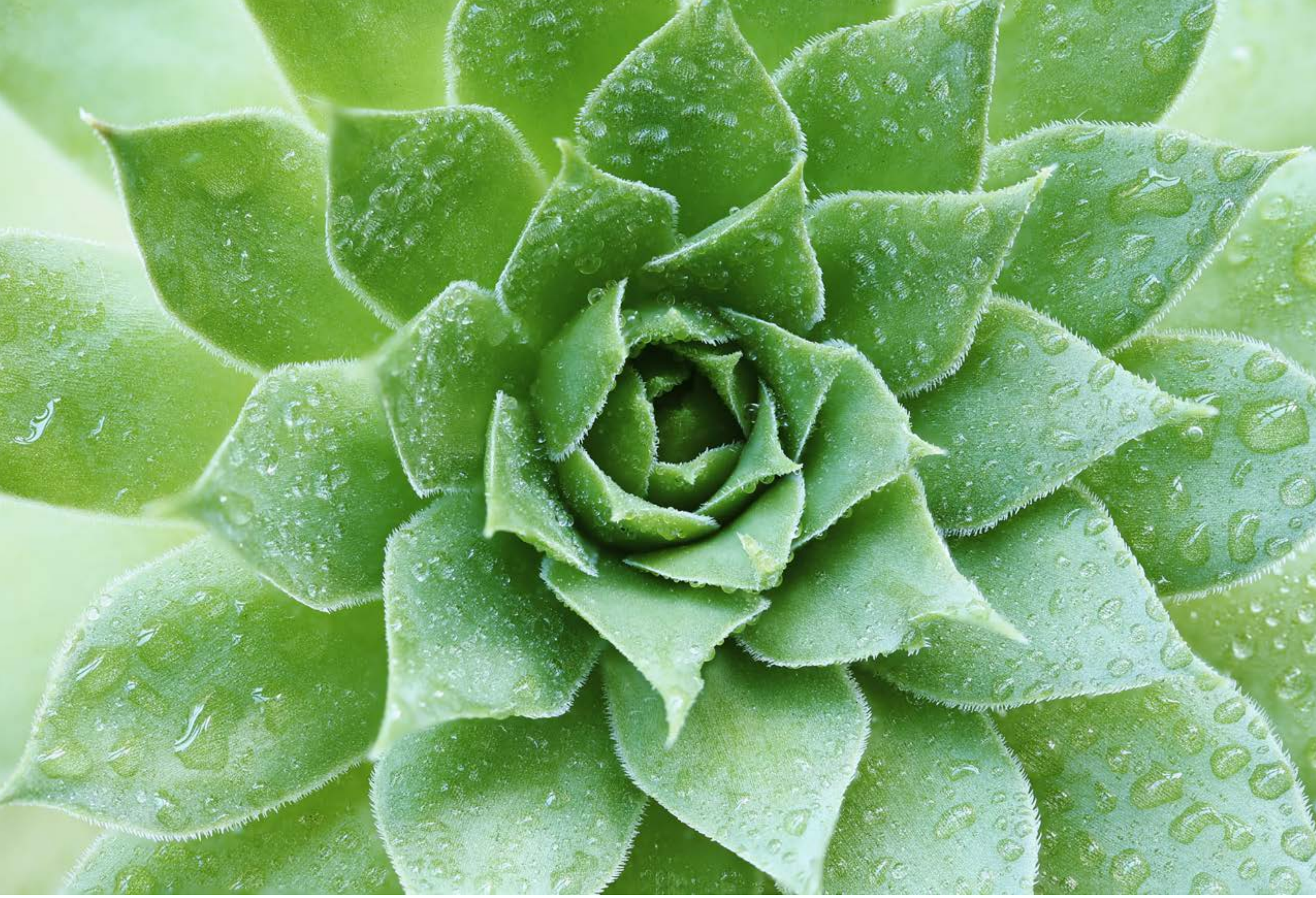
The survey results highlight practices more widely followed by companies that are creating value from sustainability than by companies that aren't. Experience also suggests that companies with effective sustainability programs tend to plan and manage these programs with the same discipline and commitment that they apply to other business initiatives. Here are a few directional considerations that executives might use to focus their companies' sustainability efforts and derive more value from them:

— *Approach sustainability issues as business opportunities.* Leading companies develop business cases for their sustainability programs based on the value that they stand to create (or protect) through their handling of sustainability issues. They set tangible, concrete aspirations for their sustainability programs and convert those aspirations into quantitative performance targets, which reflect their competitive position, their consumers' expectations, and their investors' demands.

- *Build organization-wide accountability for results.* Product-focused business units, functions such as supply-chain management, and geographic departments are the parts of a company that ordinarily generate most of its sustainability impacts. And unlike the central sustainability team, these departments also have the authority to change day-to-day operations. Recognizing this, savvy executives assign responsibility for sustainability initiatives to heads of functions and divisions and give them related performance targets. In this way, executives can hold senior managers to account for the company's sustainability achievements.

- *Seek impact through collaboration.* While companies can do a lot on their own to improve their sustainability performance, some face challenges that span industries or regions. The problem of plastic waste, for example, bedevils the entire chemicals industry, not just one company. To address these systemic difficulties, companies might form coalitions with industry peers and work together on setting new standards, promoting technological innovation, or advocating for policy shifts. Since value chains produce the majority of the typical company's environmental impact, most companies will also benefit from working closely with their value-chain partners.

The contributors to the development and analysis of this survey include **Anna Granskog**, a partner in McKinsey's Helsinki office; **Eric Hannon**, a partner in the Frankfurt office; **Solveigh Hieronimus**, a senior partner in the Munich office; **Marie Klaeyle**, a consultant in the Paris office; and **Angela Winkle**, a consultant in the Chicago office.



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Organizing for sustainability success: Where, and how, leaders can start

As sustainability becomes more of a strategic *and* operational imperative, executives must lead the way to set up a sustainability organization that's right for their companies.

by Aaron De Smet, Wenting Gao, Kimberly Henderson, and Thomas Hundertmark

Sustainability and environmental, social, and governance (ESG) issues affect how all companies do business—and increasingly so in recent years.[1] More companies, and their investors, are recognizing sustainability as a strategic priority that involves significant business risks and opportunities. But historically, few companies have organizational structures that are designed to treat sustainability as a material business issue. Instead, sustainability activities—and the organizations that support them—have focused primarily on investor relations, PR, and corporate social responsibility.

The "sustainability organizations" that still operate that way (and there are many) are tasked with managing stakeholder communications, target setting, and reporting. While those tasks are important, they are also insufficient for sustainability organizations to be successful. Our experience suggests that success is more likely when executives empower sustainability organizations to engage proactively and strategically hold them responsible for creating measurable impact. Only then will companies be able to maximize the value at stake from their sustainability initiatives (see sidebar, "A leader's guide to embedding sustainability in corporate strategy").

To get sustainability programs right, companies have big decisions to make. To start, they should choose which issues under the broader sustainability umbrella should be the responsibility of their sustainability organizations and which issues should be left to other parts of their businesses. The issues range widely, from building new low-carbon businesses and commercializing green products to managing environmental compliance and ESG reporting more proactively. As companies mobilize to respond to increasing sustainability concerns, many have struggled with the differences between sustainability and other business issues in the trade-offs involved, decision-making and governance processes, and even employee and leader mindsets.

[1] Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," *McKinsey Quarterly*, November 14, 2019, McKinsey.com.

A leader's guide to embedding sustainability in corporate strategy

To make sustainability a true organization-wide issue and a pillar of company strategy, CEOs and senior executives must be leading from the front. In our experience, leaders are most effective at doing so when they follow these three strategies (usually in this order):

— Embed sustainability in the company's strategy-setting process. This is a prerequisite for the effective management of sustainability—and something that senior leaders are best positioned to do. The goal is not simply to have a great sustainability strategy but rather a corporate strategy that includes sustainability as a core component.

— Shape the portfolio to reflect an integrated strategy. Once a company's sustainability-related priorities are clear, companies must make decisions on capital allocation, R&D funding, and portfolios accordingly.

— Scale up sustainable business practices through a full transformation. To incorporate sustainability in business planning and to empower and motivate the whole organization to take action on these issues, leaders should approach sustainability as they would any other new large-scale change effort. To ensure buy-in across the organization, it's important to be clear about which sustainability topics the company will and won't prioritize.

So how do executives build sustainability organizations that are well placed and empowered to help their companies meet stakeholders' increasing expectations, manage sustainability-related risks, *and* capture business opportunities? In this article, we outline four ways that leaders can guide the organizational redesign of their sustainability work and why they must think differently about sustainability compared with other, more traditional business issues (Exhibit 1).

Design according to sustainability *topics*, not sustainability *overall*

Sustainability is often used as a catchall term covering a great many topics. But for any given company, few topics will be of equal importance. Our work shows that companies address sustainability issues more effectively when they design their sustainability organizations to focus on each sustainability topic the company is prioritizing (for example, green hydrogen or its subtopic, operational decarbonization).

Exhibit 1

There are four key ways that executives and their companies can organize their sustainability work for success.

To support sustainability work at the topic level, our experience suggests that a modular organizational design—rather than one holistic, central sustainability organization—often works best.

To do this well, companies should define the list of sustainability topics that matter for the organization, either because they are important to the business or because they are the areas in which the company is uniquely positioned to make a difference. One way to do so is with evergreen materiality assessments,[2] which account for the potential impact from, and likelihood of, a range of issues that could affect the company. Based on its materiality assessment, a company can then develop a short list of priority topics for its sustainability organization to cover. This will help companies make better decisions on resourcing and organizing around the issues that matter to their business.

When it comes to supporting sustainability work at the topic level, our experience suggests that a modular organizational design—rather than one holistic, central sustainability organization—often works best. A modular design gives companies the nimbleness to address emerging topics in a more agile way. Indeed, many sustainability topics arise quickly: for example, in 2018, the number of earnings calls that mentioned "plastic waste" increased 340 percent year over year.[3] In practice, even if there's a dedicated center of excellence for a certain topic, it doesn't necessarily need to be part of the central team. Instead, it could be embedded in a business unit that has particular expertise on the topic or will be primarily responsible for leading the company's response to it.

One company we worked with built a carbon-management organization that distributed initiatives among different parts of the company, rather than relying on a central organization that covered all sustainability topics or that managed all of the organization's carbon initiatives. The R&D department, for example, focused on researching and developing new low-carbon innovations. A separate business unit was created to commercialize low-carbon offerings to customers. Meanwhile, manufacturing sites set their own carbon-reduction targets, embedded their decarbonization initiatives in line with site-level turnaround schedules, and were held accountable for implementing those initiatives. The procurement team focused on decarbonizing the company's supply chain. Finally, a lean central team coordinated carbon-emissions reporting and other carbon-related activities across the company.

[2] A materiality assessment is the process of identifying and prioritizing the potential sustainability topics that are most important for a company to address because of their potential impact on the business or its stakeholders. The process requires the engagement of both internal and external stakeholders, especially business-unit leaders with profit-and-loss responsibilities, investors, customers, nongovernmental organizations, regulators, and other key partners to the business.
[3] Audrey Choi, "The business case for investing in sustainable plastics," World Economic Forum, January 20, 2020, weforum.org.

Give your central sustainability team the decision rights to execute change

In our experience, it's important for companies to have a central sustainability team to coordinate their work on these topics. Our experience also suggests that companies don't need large central teams to implement their sustainability agendas successfully. While we have seen many companies start their sustainability transformations by allocating more central resources to these issues, we have also seen that having a smaller central team and more dedicated resources in the business lines that execute the detailed planning and implementation of sustainability can be most effective. In fact, among the companies we have worked with, some of those with highly effective sustainability programs have lean central sustainability organizations whose mandate is to incubate new sustainability ideas and integrate sustainability initiatives across the company.

What makes the central team particularly effective is having the decision-making authority to execute change, particularly regarding priority sustainability topics that affect multiple functions or that have a material impact on the overall organization. This authority has several dimensions. First, the central group should also engage the board of directors on critical sustainability topics, since the board holds the ultimate decision rights on such issues and the company's strategic direction. The central team should also be empowered to hold others accountable, which it can do by setting centralized targets. Individual sites or businesses then come up with specific initiatives, timelines, and plans for pursuing those targets, and the central team tracks their progress while also maintaining a corporate-wide view of the company's performance on the topic.

To ensure broad engagement in and commitment to common sustainability goals, the central team can enlist the company's leaders to develop and define a corporate-level sustainability agenda. When the central team has a clear mandate from the business, it can better see that the sustainability agenda cascades through the organization and that business units have clear guidance on which priorities to take on.

At one company with a successful sustainability organization, an existing business unit worked closely with the central sustainability team to incubate a new business for end-of-life products. Once the idea reached a defined financial milestone and level of technological maturity, the responsibility of business building shifted away from the central team to that business unit. Since the business unit was involved in the effort from the start, the transition of the business's decision rights was smooth.

To be clear, not all decisions need to be made by the central team, which could overstretch it (especially if it's a small group) and divert attention from specific priorities. Rather, cross-functional decisions and those that are highly material to the full company are best suited for central-team oversight.[4] The right to make other decisions, such as those that involve single functions, can be assigned to leaders or teams that are more closely associated with those units.

Find the structure that best fits your sustainability agenda—and your organization as a whole

Reporting structure is usually the first topic that comes to mind when companies consider organizational redesigns, and so the first question we are often asked is, "Which organizational structure is ideal for capturing the full potential of sustainability?" In reality, there is no single "right" answer for the design of a sustainability organization and no one-size-fits-all approach, beyond the general principle that the structure should be well integrated into—and compatible with—the rest of the company's setup.

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[4] For more on how to classify and make decisions appropriately, see Aaron De Smet, Gerald Lackey, and Leigh M. Weiss, "Untangling your organization's decision making," *McKinsey Quarterly*, June 21, 2017, McKinsey.com.

That said, we do see that some organizational models tend to be more effective than others at elevating sustainability as a true strategic priority (Exhibit 2).

Compared with two other models that we see most often today in which sustainability is embedded in a support function or fully decentralized within business units, these three models help link sustainability to an overall strategy and give a sustainability organization real decision rights:

— Large central team with few business-unit resources. In this model, a large central team plans—and maintains the decision rights to—most sustainability initiatives and also coordinates with individual business units that are actively working on specific sustainability issues or have expertise related to the topic. The central team incubates sustainability initiatives before handing them off to the business units and supports activities that have no other natural owners in the organization. It also ensures that sustainability priorities across the company have sufficient budgets and staff and that the organization stays focused on its priority topics. A central team may also have the best view of broader sustainability trends and stakeholder demands, though it's likely less equipped than business units to respond to new sustainability-related market opportunities and risks. As an example, Newmont Goldcorp (a leading gold-mining company) was prompted by shareholders and its board to improve its management of sustainability issues after completing a merger. It responded quickly, creating a centralized sustainability group from 2002 to 2007 to design and drive the implementation of global environmental standards across its operational sites. This central group also managed decision making and the allocation of execution resources to sustainability issues.

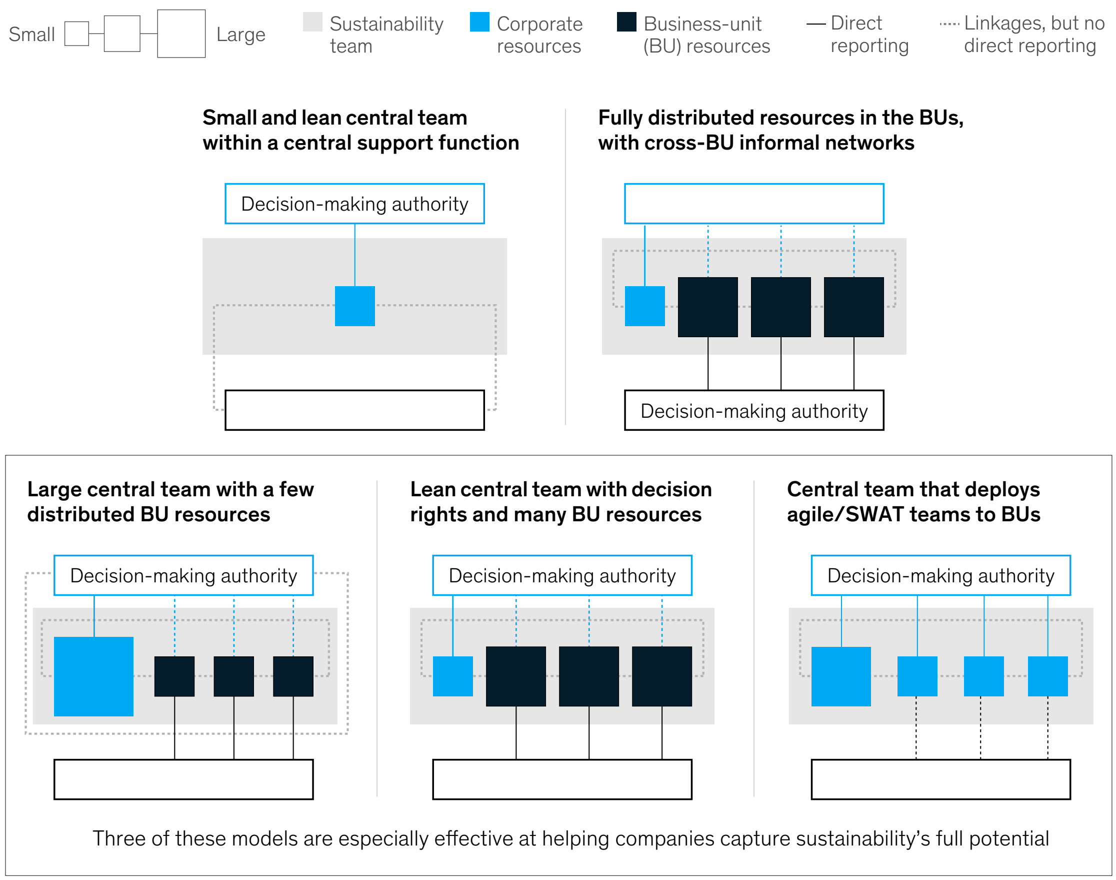
— Lean central team with decision rights and many business-unit resources. In this structure, the prioritization of sustainability topics is largely a top-down process, led by the lean central team, to ensure that a common company-wide agenda and targets are in place. Business units have a mandate to develop specific initiatives to achieve company-wide goals, which they do by deploying their own resources. Business units also have the flexibility and resources to set up and work on sustainability initiatives of their own, in line with the central team's guidance. In our experience, this structure can be most effective at companies that have already embedded sustainability in the organizational culture, which increases

There is no single 'right' answer for the design of a sustainability organization beyond the general principle that the structure should be well integrated into—and compatible with—the rest of the company's setup.

Exhibit 2

Certain organizational models tend to be more effective than others at elevating sustainability as a strategic priority.

Five commonly used models for sustainability organizations, scope of role in sustainability work



	Large central team with a few distributed BU resources	Lean central team with decision rights and many BU resources	Central team that deploys agile/SWAT teams to BUs
Pros	• Faster to elevate sustainability issues at corporate level • Centralized target setting, planning, and tracking • Consistent, cross-BU implementation of sustainability priorities	• Faster BU-level response • Empowered BUs receive clear central guidance • Less resource-intensive for central team	• Central team controls corporate sustainability agenda and resourcing • Agile resource deployment to meet evolving priorities • Easy sharing of best practices and expertise across BUs
Cons	• Resource-intensive for central team • Less responsive to BU-specific priorities • BUs not empowered to scale other BU-specific sustainability initiatives	• More speed and agility within BUs but not across BUs • Significant resource commitment from BUs	• Highly resource intensive for central team • Sustainability driven from the top down, so BUs are not empowered to drive initiatives

the likelihood that sustainability becomes a true cross-functional effort. Since 2019, this model has been in place at International Paper, a leading pulp-and-paper company. Its lean central team sets the company-wide sustainability agenda and focuses on both managing external relationships and integrating internal efforts. Meanwhile, business-line leaders drive the sustainability agenda. They set targets, develop the company's sustainability initiatives, assume responsibility for delivering on those initiatives (including the coordination of resources), and embed sustainability into day-to-day operations.

— Central team that deploys agile or SWAT teams to business units. This structure puts a central team in charge of deploying sustainability-focused task forces to individual business units. Once a task force is embedded in a business unit, it helps with the planning and initial execution of that unit's priority sustainability initiatives and builds capabilities so that the business can eventually run its own initiatives, once the task force leaves to support another unit. This facilitates the deployment of sustainability expertise and the sharing of best practices across the company, as well as the nimble reallocation of resources in response to the rapidly changing sustainability landscape. From a talent-development perspective, this model (what we call the "helix organization"[5]) also allows for a clearer separation of leaders—between those who help individuals develop capabilities and those who oversee employees' day-to-day work. The result is that sustainability talent can be developed both ways.

Prioritize the design of processes and governance—rather than reporting lines—that account for sustainability's complexity and dynamic nature

In our work on organizational redesign, we have found that many companies' default mode is to focus solely on reporting structure. But we know from experience and research that going beyond "lines and boxes" corresponds with a much higher chance for redesign success: in a McKinsey Global Survey on organizational redesigns, respondents were nearly three times more likely to report successful redesigns if they focused on improving multiple elements of the organization (for example, performance management, business processes, and culture), not just on changing reporting lines.[6] With respect to sustainability, which involves reorganizations that are more complicated and multifaceted than those of a typical function—and priorities that can shift much more quickly than in other areas of the business—we have found that it's critical to think about redesigning sustainability-related processes and governance early on. Several guiding principles can help with this kind of effort.

For one, companies' processes for making sustainability-related decisions should be robust and clearly define when an issue or decision should be escalated from the business unit to the central sustainability team. Decision-making processes should also include frequent discussions among stakeholders and fast decision cycles so that cross-functional or high-level topics can be identified and resolved quickly.

In most cases, the central team should be empowered to make decisions on topics that individual business units can't resolve on their own. If the central team, in turn, finds it can't resolve high-priority issues, it can escalate them to the executive team or a C-suite sustainability council. We have seen many companies fail to adapt their cadence on engaging with sustainability issues as they would with other topics. But that's what sustainability necessitates, since many of these topics require quicker decision making and responses than other business issues. For many companies in traditional and mature sectors (for example, petrochemicals, cement, steel, and other heavy industrials) that are used to longer decision-making cycles, this may require a significant mindset shift. The executive team can help effect such

[5] Aaron De Smet, Sarah Kleinman, and Kirsten Weerda, "The helix organization," *McKinsey Quarterly*, October 3, 2019, McKinsey.com.
[6] "The secrets of successful organizational redesigns: McKinsey Global Survey results," July 1, 2014, McKinsey.com.

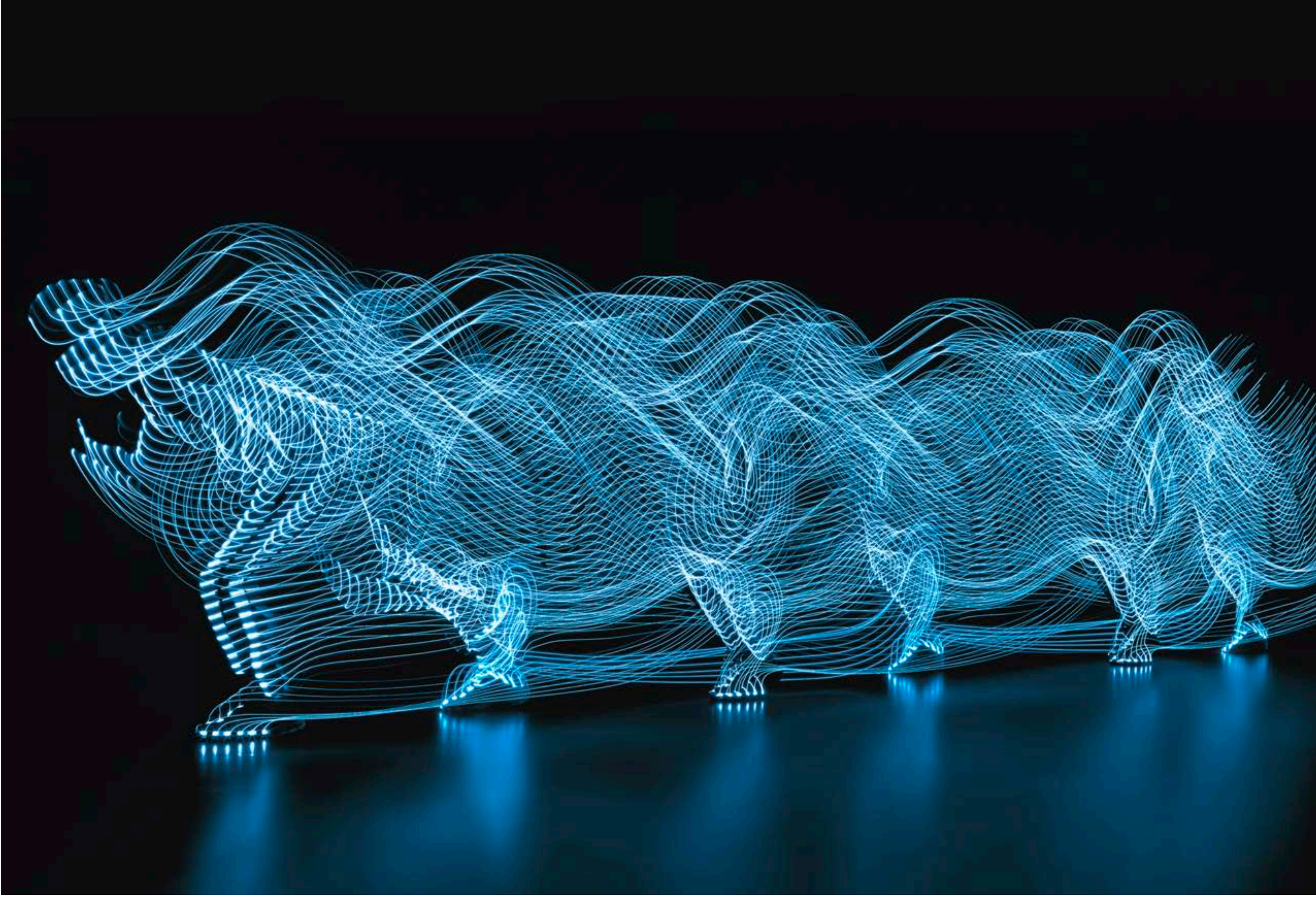
a shift by clarifying that sustainability is a strategic priority that requires different decision-making approaches.

Another principle of effective sustainability processes and governance pertains to capital allocation. Sustainability investments often have different risk–return profiles and greater uncertainty than other, more traditional investment types. In our experience, many companies that lead on sustainability have set aside a separate pool of funds dedicated to sustainability initiatives, defined different hurdle rates for sustainability investments, introduced an internal carbon price to account for carbon impact and related risks, and put in place integrated financial and sustainability criteria to facilitate capital-allocation and M&A decisions.

Finally, it's valuable for companies to develop sustainability-specific performance metrics. While the specific metrics will vary depending on the topic, the same principles of good performance management of other business activities also apply to sustainability: setting measurable targets (both financial and nonfinancial), establishing incentives (such as linking compensation to sustainability performance), and putting in place regular performance reviews of sustainability.

Sustainability is no longer an issue of compliance for most companies but rather a strategic and operational one. Once senior leaders integrate sustainability into their corporate strategy, they will benefit from having a dedicated organization to support their sustainability efforts. There is no right structure that applies to every company; each will need a structure of its own and will likely need to adjust this structure as business conditions and requirements change. A well-designed sustainability organization, we find, can give the company the capabilities that it needs to capture value and manage risks from sustainability in a systematic and even transformational way.

Aaron De Smet is a senior partner in McKinsey's New Jersey office; **Wenting Gao** is an associate partner in the Houston office, where **Thomas Hundertmark** is a senior partner; and **Kimberly Henderson** is a partner in the Washington, DC, office.



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The new digital edge: Rethinking strategy for the postpandemic era

Our latest survey confirms that the future will belong to companies that put technology at the center of their outlook, capabilities, and leadership mandate.

Introduction

One year into the COVID-19 crisis, our newest McKinsey Global Survey on digital strategy[1] indicates that the pandemic has increased the pace of business and that technology capabilities will be critical to companies' COVID-19 exit strategies as well as to what comes next. After seeing how the pandemic had sped up the adoption of digital technologies by several years, we took a closer look at how companies are rethinking the role of digital technology in their overall business strategy and how to conduct business at the quickening pace that's now needed to operate.

The imperative for a strategic approach to technology is universal, yet some companies are already leading the pack; their responses show that better overall technology capabilities, talent, leadership, and resources (what we call a company's "technology endowment") are linked to better economic outcomes. At the same time, the results confirm that many organizations could be missing opportunities to invest in the areas of their business models that are most at risk of digital disruption.

Companies with better overall technology capabilities, talent, leadership, and resources are seeing better economic outcomes.

[1] The online survey was in the field from January 19 to January 29, 2021, and garnered responses from 1,140 C-level executives, senior managers, and business-unit, department, or division heads representing the full range of regions, industries, company sizes, and functional specialties.

The pandemic has dramatically increased the speed at which digital is fundamentally changing business

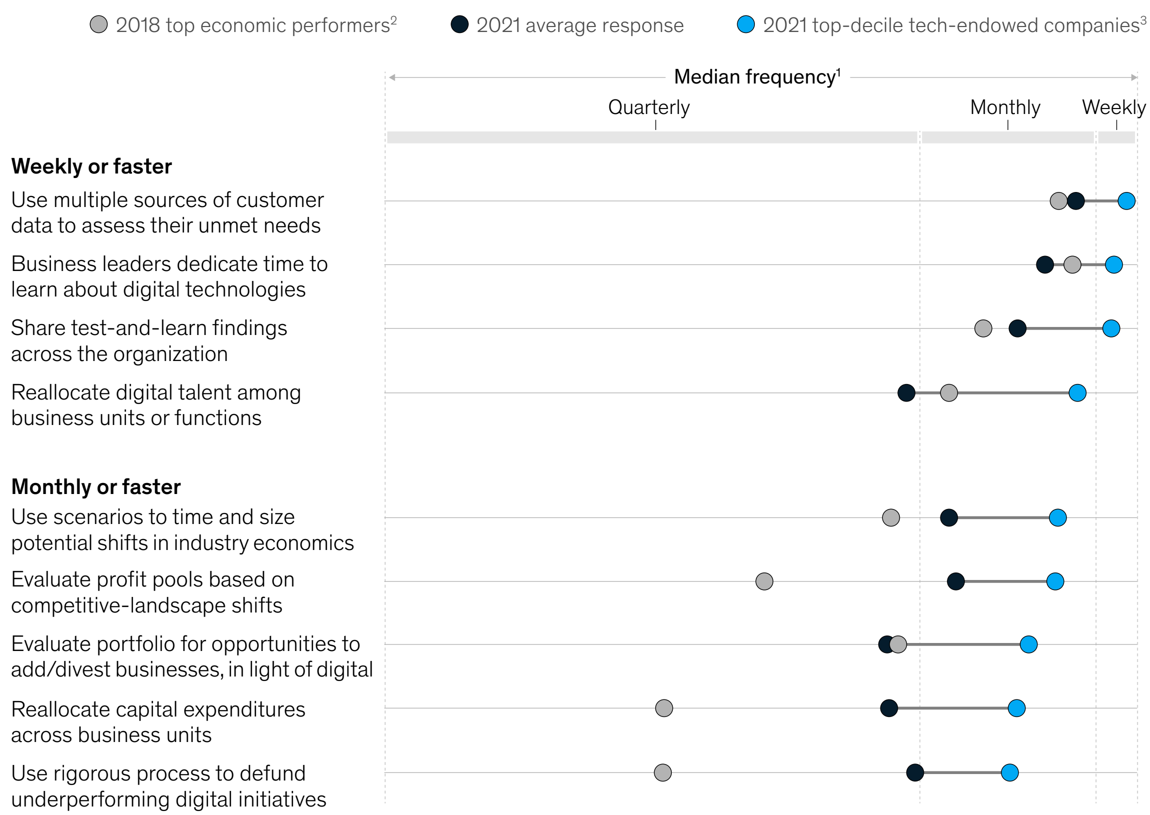
Our previous survey showed that across key areas of the business model, companies' overall adoption of digital technologies had sped up by three to seven years in a span of months. The newest results show that this acceleration is also happening at the level of core business practices: what was considered best-in-class speed for most business practices in 2018 is now slower than average (Exhibit 1). And at companies with the strongest technology endowments,[2] respondents say they are operating at an even faster pace.

[2] Companies with a top technology endowment are those where respondents strongly agreed with at least seven statements (out of 13 total) about the role of technology in their organizations' strategies and the overall role of technology in their organizations; n = 158.

Exhibit 1

The COVID-19 pandemic has fundamentally changed the pace of business, and the companies with superior technology capabilities are winning the race.

Median frequency of core business practices[1]



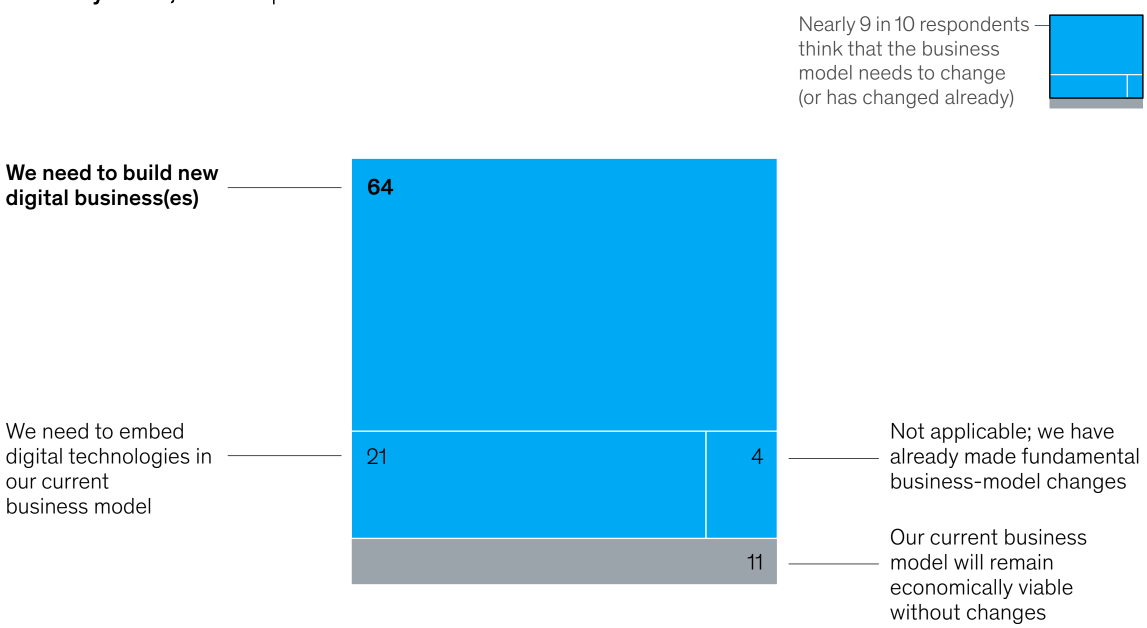
[1]Frequencies shown are the median values from a histogram, which was constructed by assigning "daily" responses a value of 0; "weekly," 1; "monthly," 2; "quarterly," 3; "annually," 4; "every few years," 5; and "never," 6. The question also asked about the frequency of evaluating M&A opportunities as part of every strategy-setting discussion. These responses are not shown because M&A typically requires a longer time frame than the other operational practices tested, often due to regulatory reasons.
[2]Respondents of the 2018 survey who say their organizations have a top-decile rate of organic revenue growth (ie, of 25% or more in past 3 years) relative to other respondents; n = 138.
[3]Companies with a top-decile tech endowment are those where respondents strongly agreed with at least 7 statements (out of 13 total) about the role of technology in their organizations' strategies and the overall role of technology in their organizations; n = 158.

But it's not only the pace of business that the COVID-19 crisis has fundamentally changed. According to the survey, many respondents recognize that their companies' business models are becoming obsolete (Exhibit 2). Only 11 percent believe their current business models will be economically viable through 2023, while another 64 percent say their companies need to build new digital businesses to help them get there.

Exhibit 2

Looking toward 2023, most companies will need to build new digital businesses to stay economically viable.

Changes needed to make company's business model economically viable by 2023, % of respondents[1]



[1]Respondents who answered "don't know" are not shown; n = 1,140.

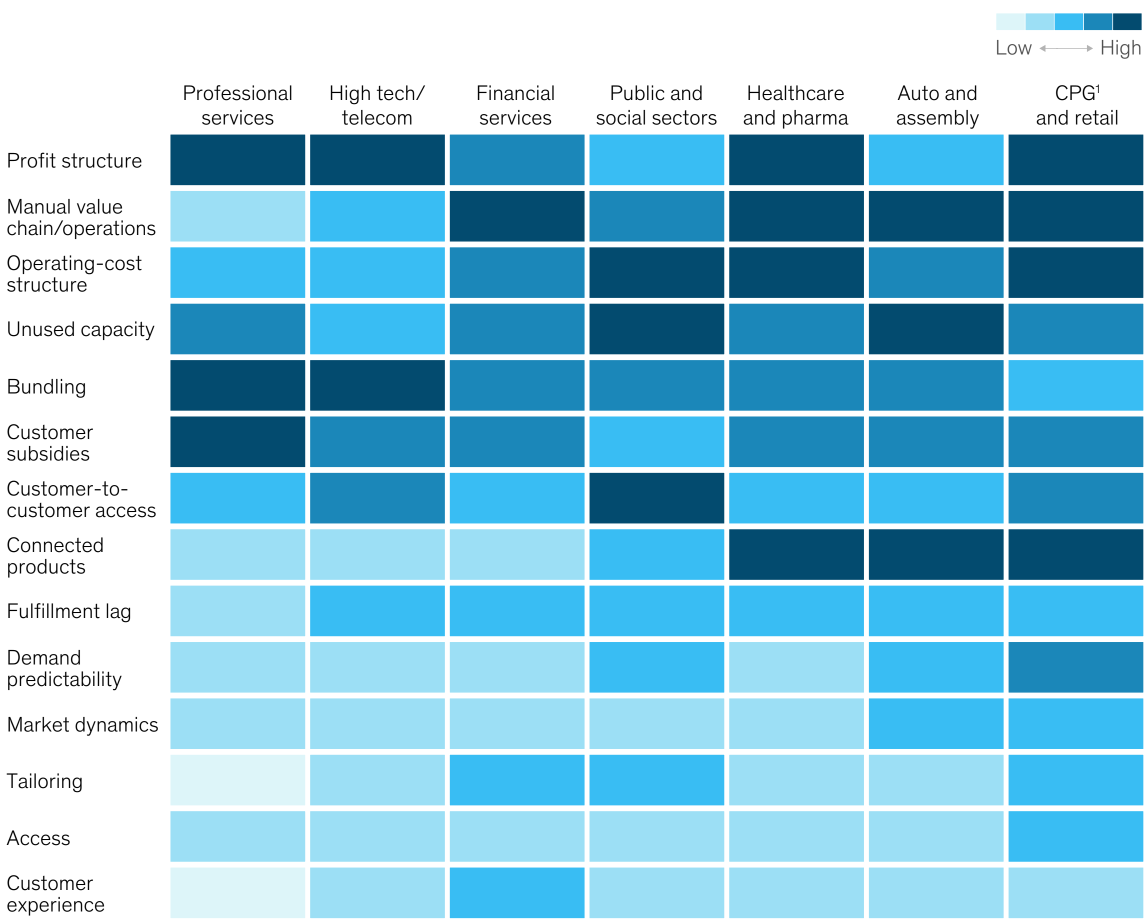
At the same time, the pandemic has created new vulnerabilities to—along with new opportunities from—future disruptions. We know from experience that customers, employees, and value-chain partners have all increased their use of technology, which has made the barriers to digital disruption even lower than before the crisis and paved the way for more rapid, technology-driven changes going forward. In our survey, respondents in every sector say their companies have significant vulnerabilities, especially to their profit structures, ability to bundle products, and operations (Exhibit 3).

We also looked at the areas of their business where industries have been investing and, for the most part, those investments don't align with the areas that are most prone to disruption (or that offer the highest returns). For example, many healthcare and pharma companies are investing in tailoring their offerings, enabling on-demand access to products and services, and improving overall customer experience. Yet, according to the survey, these businesses face greater risks of disruption in their value chains, the structure of their operating costs, and the types of products they offer.

Exhibit 3

In all sectors, respondents report several areas of their businesses that are very vulnerable to digital disruption.

Level of business area's potential vulnerability to disruption, by industry, % net agree



[1]Consumer packaged goods.

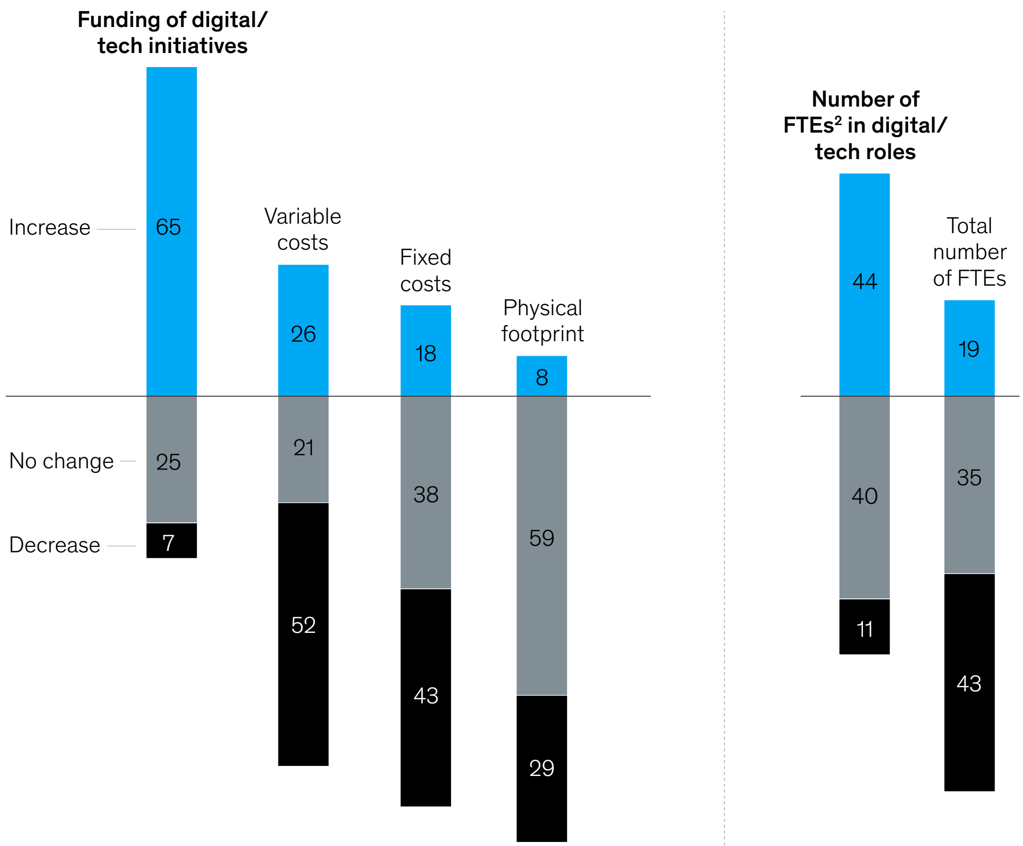
To meet new demands, companies are making digital and technology investments across the business model

One marker of technology's increasing importance to both strategy and operations is that companies devoted more resources to their digital and technology capabilities during the pandemic, even as they cut resources from other parts of the business. According to the survey results, the funding of digital and technology initiatives increased, as did the numbers of full-time equivalents in digital and technology roles (Exhibit 4).

Exhibit 4

Spending on digital and technology increased during the pandemic, despite belt-tightening elsewhere in the business.

Changes in business metrics, past year, % of respondents[1]



[1]Respondents who answered "don't know/not applicable" are not shown; n = 1,140.
[2]Full-time equivalents.

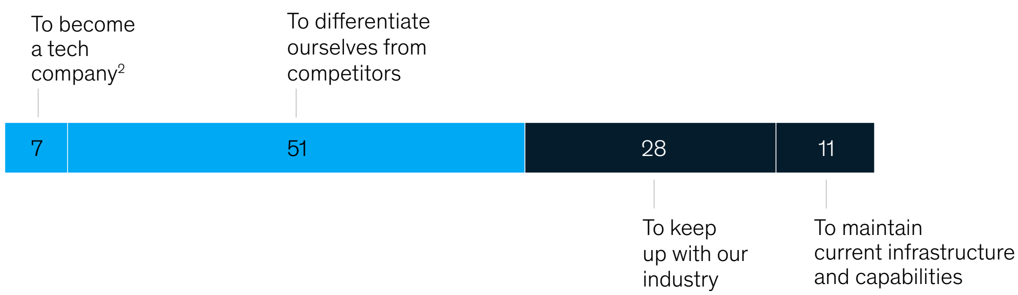
Consistent with last year's findings that executives have started to take a more strategic view of technology,[3] thinking of it as more than a mere cost driver, more than half of this year's respondents say their companies are looking to technology as a way to strategically differentiate themselves from competitors (Exhibit 5).

[3] "How COVID-19 has pushed companies over the technology tipping point—and transformed business forever," October 5, 2020, McKinsey.com.

Exhibit 5

After the acceleration of digital adoption during the pandemic, a majority of companies view technology capabilities as a strategic differentiator.

Level of ambition for organizations' planned investments in digital and technology, % of respondents[1]



[1]Respondents who answered "don't know/not applicable" are not shown; n = 1,140.
[2]That is, the organization's core value proposition is based on the technology and data it produces.

The highest-performing companies made bolder investments in technology and possess stronger overall capabilities

We know from past research that bolder, at-scale investments in technology are significantly more likely to support a successful transformation than those that are smaller in scope. To achieve their ambitions, it's critical that organizations understand what it really means to differentiate from others on their technology—especially since "technology" and "digital" are such broad terms and mean different things at different organizations. So we asked respondents about specific elements of technology that, based on our experience and prior research, underpin successful digital transformations and make up a company's technology endowment.[4] The results suggest a clear link between the technology endowment and economic outperformance (Exhibit 6). When looking at the technology endowment's individual capabilities (the survey asked about 13 in total), the top-decile economic performers are already significantly ahead of their peers on nearly every one.[5] For example, these respondents are nearly twice as likely as others to say they fill key technology roles with high-quality talent in a timely manner. At the same time, the results confirm that even the top performers have room to improve and strengthen their tech endowments.

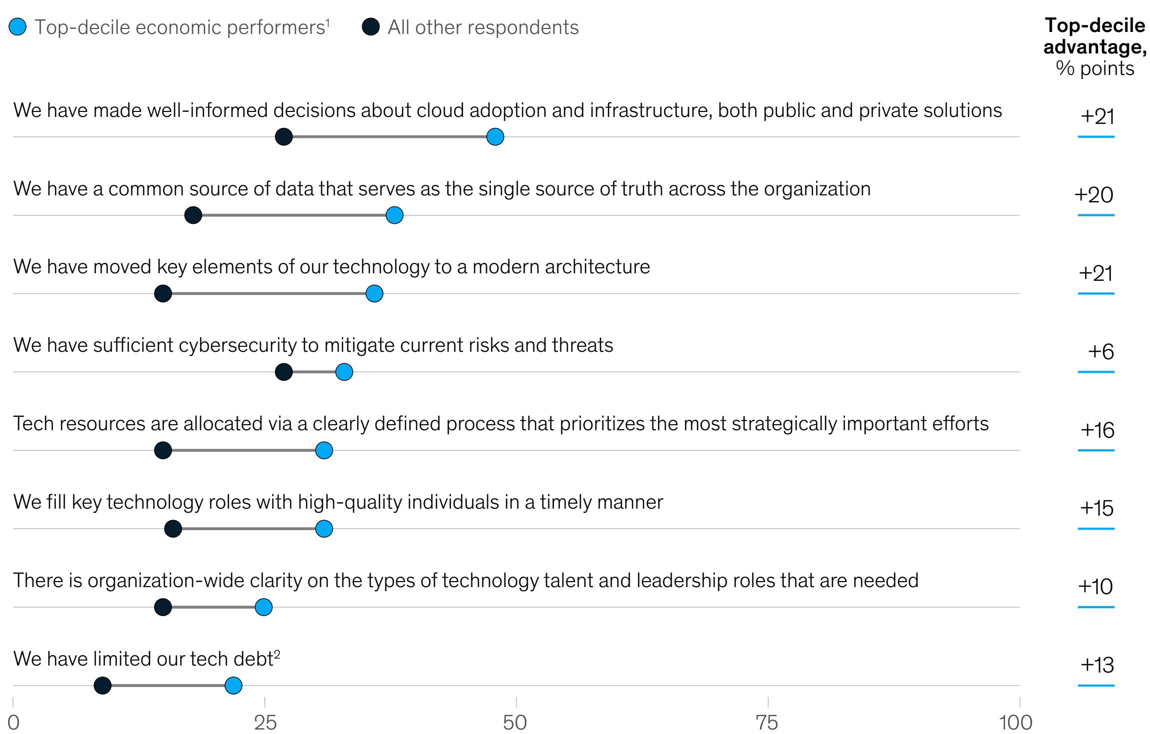
[4] For more on McKinsey's thinking on *strategic* endowments, see "How to make the bold strategy moves that matter," December 6, 2019, McKinsey.com.

[5] Respondents who report increases of at least 15 percent in their companies' revenue and in earnings before interest and taxes (EBIT) over the past three years.

Exhibit 6

Top performers are already significantly ahead of their peers on almost all elements of their technology endowment, making catching up a challenge.

Share of respondents who strongly agree with each statement, %



[1] Respondents who report increases of at least 15% in their companies' revenue and in earnings before interest and taxes (EBIT) over the past 3 years; n = 118.

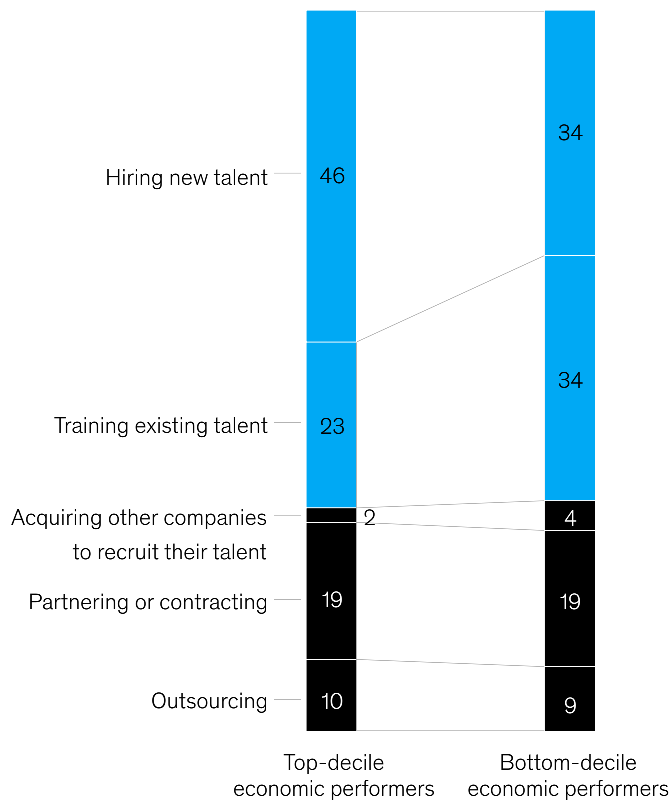
[2] That is, the number of digital and technology projects, products, or services that were underengineered due to tight deadlines.

Talent poses a perennial challenge to companies that are transforming their business through digital and technology—as many of our respondents say their companies aim to do. As organizations make their plans for filling critical talent gaps in technology, from the board to the front line, the results suggest that there is no silver bullet to filling skill gaps (Exhibit 7). Top economic performers report a greater reliance in hiring new employees. At other companies, respondents report an equal focus on hiring and retraining their current people, and the two groups rely equally on partnering or contracting.

Exhibit 7

Top performers are more likely than their peers to fill talent gaps through hiring.

How organizations are planning to fill talent gaps, % of respondents[1]



[1]Respondents who answered "don't know/not applicable" are not included in the analysis. For top-decile economic performers, n = 115; for bottom-decile economic performers, n = 165.

Catching up with the leaders (much less surpassing them) will be increasingly difficult, for the top economic performers have already taken more actions than peers to achieve their technology objectives. Their responses show that these organizations are more likely to invest in talent, create new partnerships (including with competitors), and increase their R&D spending (Exhibit 8).

Exhibit 8

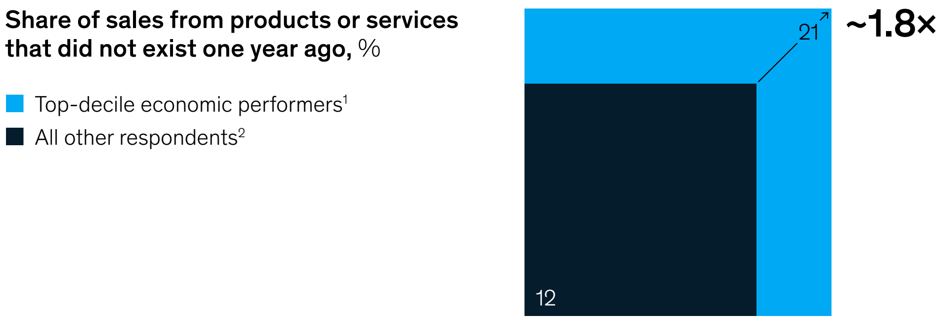
Compared with their peers, the top economic performers have been more likely to invest in new partnerships, talent, and R&D.

How organizations have increased their digital and technology capabilities, past year, % of respondents

Top-decile performers have also taken a bolder approach to innovation and now obtain a much larger share of their sales from products or services that didn't exist one year ago (Exhibit 9).

Exhibit 9

Top economic performers have been more innovative than their peers during the COVID-19 crisis.



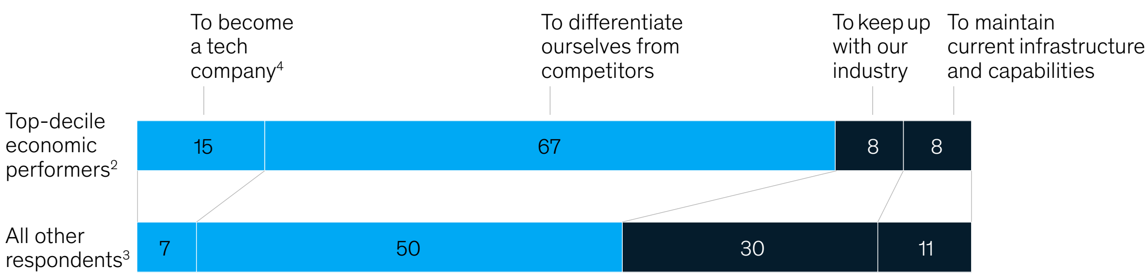
[1]n = 91.
[2]n = 636.

What's more, the top-decile performers are making more aggressive plans to differentiate themselves with technology, with some preparing to reinvent their value proposition altogether (Exhibit 10).

Exhibit 10

Looking ahead, top economic performers are planning to double down on tech as a differentiator.

Level of ambition for organizations' planned investments in digital and technology, % of respondents[1]



[1]Respondents who answered "don't know/not applicable" are not shown.
[2]n = 118.
[3]n = 1,022.
[4]That is, the organization's core value proposition is based on the technology and data it produces.

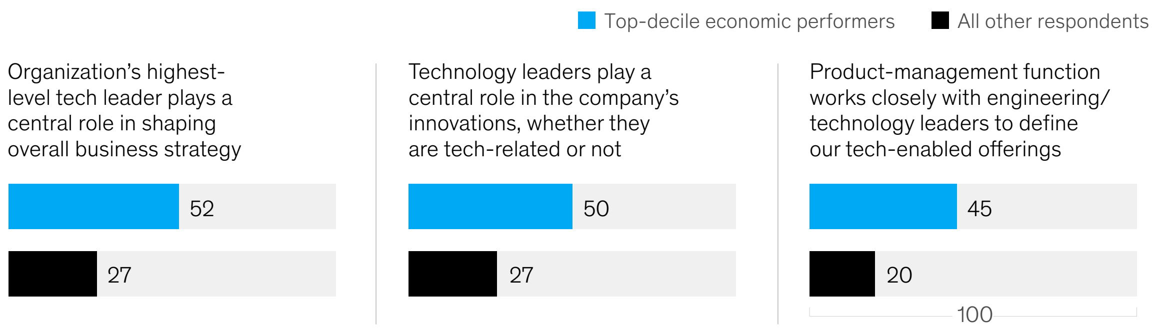
Tech-savvy leadership helped set top performers apart—and will be even more valuable in the future

Given technology’s growing importance to business success, it’s perhaps not surprising that top performers are nearly twice as likely to have technology leaders who actively shape overall strategy (Exhibit 11). They’re also more likely to give tech leaders a major role in innovation and product development.

Exhibit 11

Effective digital- and technology-driven strategies require deep involvement from technology leaders.

Share of respondents who strongly agree with each statement, %

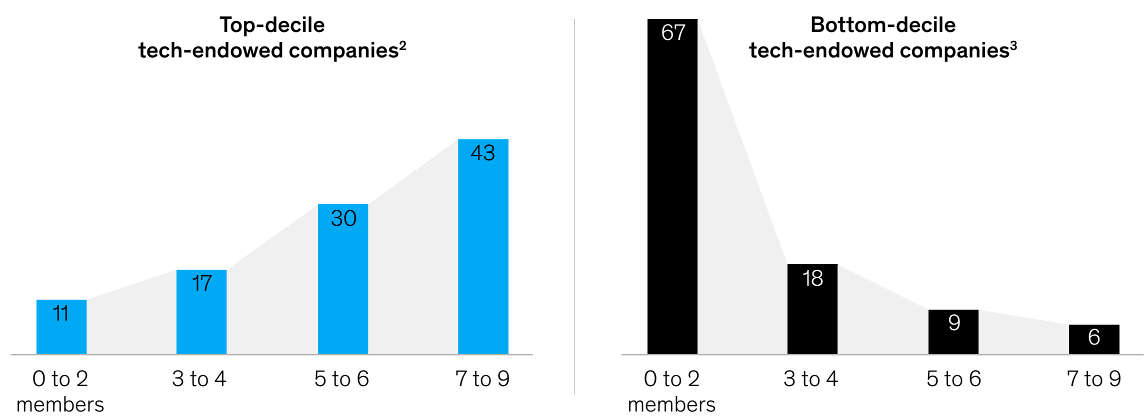


Despite the importance of involving technology leaders in business decisions, it isn’t sufficient for companies to have a single technology leader responsible for driving a top-performing and digitally enabled business strategy (Exhibit 12). We asked how boards of directors, C-suite leaders, and business-unit heads are engaging in technology. Respondents at the top economic performers are nearly 2.5 times likelier than bottom-decile companies to say seven or more of these roles are leading the technology-related thinking for their organizations. There are even bigger differences at organizations with a top-decile technology endowment: those respondents are more than 7.0 times likelier than the bottom decile to report at least seven tech-savvy leaders.

Exhibit 12

Organizations with tech-savvy leadership teams significantly outperformed their peers in their ability to build top-performing tech endowments.

Number of tech-savvy company leaders,[1] % of respondents



Note: Figures may not sum to 100%, because of rounding.
[1]That is, company leaders who are industry leaders in finding ways to apply new technologies or who consistently identify how new technologies could change or transform the business and lead the implementation of these technologies.
[2]Companies with a top-decile technology endowment are those where respondents strongly agreed with at least 7 statements (out of 13 total) about the role of technology in their organizations’ strategies and the overall role of technology in their organizations; n = 157.
[3]Companies with a bottom-decile technology endowment are those where respondents did not strongly agree with any statements (out of 13 total) about the role of technology in their organizations’ strategies and the overall role of technology in their organizations; n = 377.

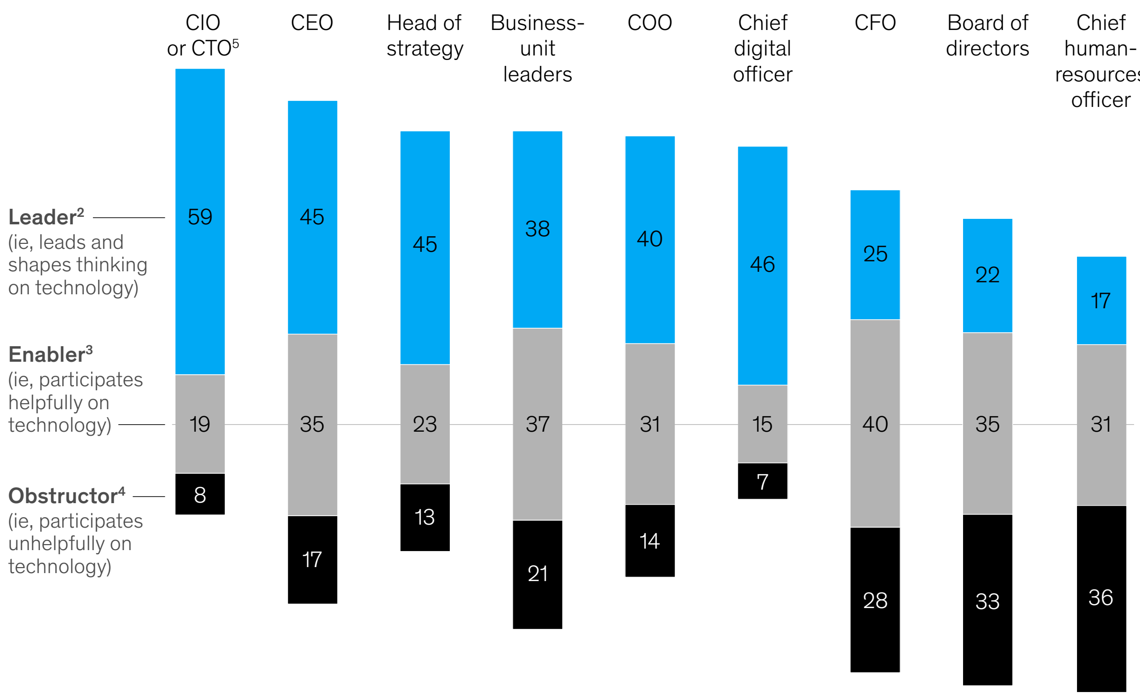
The importance of digital poses a challenge for company leaders: few are used to engaging with technology, even as it is transforming the requirements of nearly every role and becoming part of everyone's job (Exhibit 13). Boards are being asked to communicate to the market about their organization's investments in digital technologies and how that will enable them to keep pace with competitors. Chief human-resources officers need to not only hire new types of talent but also address questions about artificial intelligence's role in changing the types and numbers of people their business requires.[6] CFOs need to make larger and faster decisions on investments in digital technologies and, in many cases, spearhead the acquisition of digital companies. Yet according to the survey, the majority of current leaders lack the knowledge or experience to pioneer ways to apply new technologies or consistently identify how new technologies can transform their business. They need to become technology "leaders"—rather than "enablers"[7] or "obstructors"[8]—at their respective organizations.

[6] For more information, see "The future of work after COVID-19," McKinsey Global Institute, February 18, 2021, on McKinsey.com.
[7] That is, company leaders who respond in a well-informed manner when others raise decisions related to technology.
[8] That is, company leaders who respond sporadically and not always in a well-informed manner in technology-related discussions or who are not engaged at all in technology-related discussions.

Exhibit 13

Across the leadership team, the call to become more tech savvy is urgent—even for roles that have typically engaged very little with technology.

Level of engagement by role, % of respondents[1]



[1]Respondents who answered "don't know" are not shown; n = 1,140.
[2]That is, company leaders who are industry leaders in finding ways to apply new technologies or consistently identify how new technologies could change or transform the business and lead the implementation of these technologies.
[3]That is, company leaders who respond in a well-informed manner when others raise technology-related decisions.
[4]That is, company leaders who respond sporadically and not always in a well-informed manner in technology-related discussions or are not engaged at all in technology-related discussions.
[5]Chief information officer or chief technology officer.

The time is now for companies to make bold investments in technology and capabilities that will equip their businesses to outperform others.

Looking ahead

The corporate recovery from the COVID-19 crisis will involve permanent changes to many dimensions of an organization: the pace at which it conducts its business, the very nature of that business's value proposition, and the talent, capabilities, and leadership that are necessary for success. With digital and technology-driven disruptions creating a winner-takes-all dynamic in more and more industries, only a small subset of organizations is likely to thrive—and even these companies have much more room to strengthen their technology endowments. Our survey results confirm not only that a strong technology foundation is critical but also that leading companies are far ahead of competitors in building theirs. For everyone else, the time is now to make bold investments in technology and capabilities that will equip their businesses to outperform others in a rapidly evolving landscape.[9]

[9] Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," McKinsey Quarterly, February 13, 2018, McKinsey.com.

The contributors to the development and analysis of this survey include **Jeff Galvin**, a senior partner in McKinsey's Tokyo office; **Laura LaBerge**, a director of capabilities for digital strategy in the Stamford office; and **Evan Williams**, an associate partner in the Sydney office.

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Strategy for a digital world

A winning digital strategy requires new twists on familiar moves.

by Simon Blackburn, Jeff Galvin, Laura LaBerge, and Evan Williams

By accelerating digital adoption, the COVID-19 pandemic has widened the gap between the top and bottom companies on the power curve of economic profit,[1] amplifying winner-takes-most dynamics and further separating digital leaders from also-rans. Competitive differentiation, now more than ever, emerges from superior digital capabilities and technology endowment, more agile delivery, and a progressively more tech-savvy C-suite.

Digital's ascendancy is visible not only in the dominance of hyperscale tech companies but in the success of non-digital-native companies such as John Deere, Goldman Sachs, BHP, Disney, and Bosch, among others. These companies have invested heavily in new digitally enabled strategies and business models. Not only did they enter the pandemic with bigger technology endowments[2] than their peers—they continued to outspend them on digital technology as the pandemic went along.

Legacy companies looking to make comparable performance improvements should start by revisiting the classic strategy moves that, individually and in combination, have been proven to jump companies up the power curve of economic profit.[3] By adapting these classic strategies in sometimes counterintuitive ways, companies can build a winning strategy in an era of digital disruption (Exhibit 1). This article sets out a road map for doing so.

[1] Economic profit—the total profit after the cost of capital is subtracted—measures the success of a company in beating the market. Plotting each company's average economic profit reveals a power curve showing that while most companies effectively earn their cost of capital, only a few companies, all of them in the top quintile of the distribution, generate significant economic value.
[2] Technology endowment refers to the sum of a company's overall digital technology capabilities, talent, leadership, and resources.
[3] Using empirical research, our colleagues described five "big moves" that enabled companies to outperform on the power curve of economic profit; see Chris Bradley, Martin Hirt, and Sven Smit, *Strategy Beyond the Hockey Stick: People, Probabilities, and Big Moves to Beat the Odds*, Hoboken, NJ: John Wiley & Sons, 2018. Further research since then suggests the shape and magnitude of these moves may be changing in response to a more digital and tech-enabled world.

Exhibit 1

Digital strategy is changing the big moves that drive companies to outperform their competitors.

Big moves	What worked in the past 10 years	How technology and digital are changing the game
Differentiation improvement	A company's average gross margin must exceed its industry's by 30% over 10 years	Most companies must differentiate by delivering new digital products, services, and experiences faster than competitors and capturing winner-takes-most dynamics
Productivity improvement	SG&A[1] activity relative to industry in top 20% of companies; labor relative to industry in top 30% of companies	The bar for cost performance is lean greenfield attackers instead of the most efficient incumbent peer
Capital expenditure	Maintaining a ratio of capital expenses to sales in excess of 1.7 times the industry median for at least 10 years	Companies are either investing big in differentiating tech assets or going "capital light"
Resource reallocation	Shifting >50% of capital spending across different business units over 10 years	Because digital is shifting value pools more rapidly, companies must reallocate resources at a faster pace to ensure they are aligned with tailwinds and growth
Mergers, acquisitions, and divestments	Series of smaller deals amounting to >30% of market capitalization over 10 years; no deal >30% of market capitalization	Companies are anchoring on a single large digital acquisition to leapfrog their digital capabilities and culture before embarking on programmatic M&A

[1]Selling, general, and administrative.

Source: Corporate Performance Analytics by McKinsey; McKinsey analysis

Drive differentiation with technology and digital

The first of these classic moves describes the business-model innovations and pricing advantages that improve a company's gross margin. To jump into the top quintile of performance on the power curve of economic profit, your gross margin needs to reach the top 30 percent in your industry over a ten-year period. As digital technology becomes ever more important, the sources of these innovations and advantages are now shifting from traditional sweet spots into less familiar terrain, such as using digital technology to innovate products, services, and business models.

John Deere, for example, now differentiates through an Internet of Things (IoT) ecosystem that provides digital services to customers, enhancing the value delivered to customers by its machinery. Carmakers were previously differentiated, in part, by the quality of their combustion engines. But as cars continue morphing into "computers on wheels," automakers are looking to differentiate through software, which has traditionally been outside their core competence. No wonder they are looking to quadruple hiring for automotive-software developers.

These new sources of differentiation are not lost on executives, most of whom realize that digital technology is a strategically vital competitive differentiator, not just for business-model innovation but for productivity, cost excellence, and other objectives (Exhibit 2).

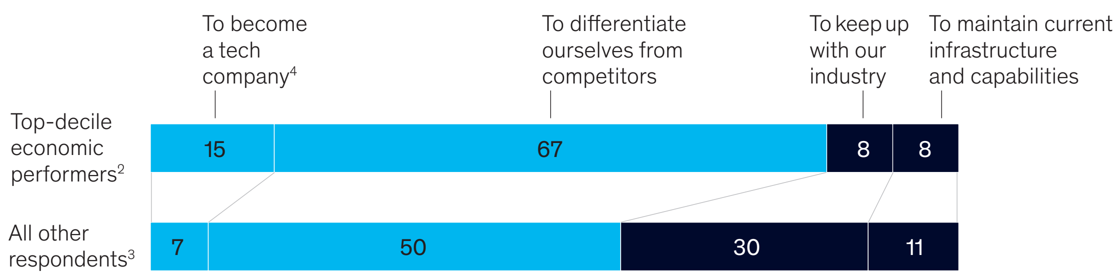
In some cases, differentiation will mean getting software into the core of your business model and go-to-market approach. Other times, it will require building new digital platforms inside the confines of traditional legacy corporations, as financial-services giant Allianz succeeded in doing with Allianz Direct—a direct-to-consumer auto-and-home-insurance business served on a single digital platform across multiple European markets.

In still other cases, differentiation may require looking beyond the boundaries of the organization to digitally enabled ecosystems with interconnected services that fulfill a variety of users' cross-sectoral needs in one integrated experience. For instance, new entrants in the housing market—such as the United Kingdom's ZPG or Zillow in the United States—are looking to create end-to-end ecosystems spanning search, property comparisons, mortgage shopping, household moving, phone and cable company reconnections, and access to home-improvement professionals. Kakao and WeChat are looking to do the same, in South Korea and China, respectively. We see evidence of both incumbents and tech companies looking to develop ecosystem plays across traditional industry boundaries in a broad range of sectors.

Exhibit 2

Top performers plan to double down on tech

Level of ambition for organizations' planned investments in digital and technology, % of respondents[1]



Note: Figures may not sum to 100%, because of rounding.
[1]Respondents who answered "don't know/not applicable" are not shown.
[2]N = 118.
[3]N = 1,022.
[4]That is, the organization's core value proposition is based on the technology and data it produces.

Drive digital productivity from both inputs and outputs

The second classic move relates to productivity. Our 2018 research showed that jumping into the top quintile of performance, or staying there, required a productivity improvement rate in selling, general, and administrative (SG&A) activity in the top 20 percent of the companies in your industry over a ten-year period, and an overall labor productivity improvement rate in the top 30 percent.

Digital disruption—for example, the ability of smaller players to leverage the public cloud and access large-scale data sets—is now changing the math on productivity in many industries. Consider how the data-driven automation of insurance-claim filing has, in some instances, reduced costs by as much as 70 percent in that industry. Across the board, executive teams should now assume the productivity bar has shifted from the leanest of their incumbent peers to that of greenfield, digital-native attackers boasting a high degree of digitization, straight-through processing, and largely variable cost bases.

As they look to meet this new bar, legacy companies may find that remote working and the mass migration to digital channels has helped them discover unexpected savings from cheaper customer interactions and—in some cases—the ability to let go of real estate as they shift toward hybrid working. Companies have also accelerated their tech enablement by moving toward agile operating models across the organization; by automating the cloud-based provisioning of infrastructure and delivery of applications; and by using AI to optimize retail footprints and sales forces, among other examples.

Automation, for example, is becoming increasingly prevalent, with rapid advances since the early days of industrial applications and robotic process automation. For instance, several US grocery stores took advantage of the pandemic-driven surge in sales and the need to decrease the number of people in store at a given time to invest in robots that helped clean floors and shelve inventory—investments that could provide these grocers longer-term cost savings. We see this happening in B2B as well, for example, with Schneider Electric's acquisition of industrial-automation provider ProLeiT, and Microsoft's acquisition of a software robotic-automation platform.

Of course, productivity gains aren't all about cutting costs. Productivity improvements from technology investments also arise through innovation. High average productivity, after all, comes about through some combination of producing the same or more output for less input, or higher output from the same or fewer inputs. Digital winners typically rely on hyperscalable software-based business models that can rapidly scale up the number of users and revenue with only minimal changes to the underlying cost structure.

Invest smart in the tech that sets you apart

Effective capital spending is another of the classic strategies companies have used to jump up (or remain at the top of) the power curve of economic profit. Top-quintile companies on that curve have boasted a ratio of capital expenses to sales in excess of 1.7 times the industry median for at least ten years. But strong capital programs make sense only when companies have the foundations for profitable growth in place, and in the presence of underlying demand for the additional capacity capital programs generate. Absent these, companies risk accelerating projects that destroy value rather than create it.

As technology and digital become increasingly important enablers for business-model innovation and productivity improvement, companies that outperform their peers are focusing more of their capital investment on technology and digital assets. This proved even more true during the pandemic, as further clarity about where and how best to invest in technology also emerged. Top economic performers entered the crisis ahead of their peers on technology spending, and out-invested them during the course of the pandemic—particularly with regard to talent, building new partnerships, and investing in R&D.

The pandemic has made clear that, while you may still need to out-invest peers to win, where you direct that investment and who you consider "peers" when evaluating that level of investment may vary according to how you are seeking to differentiate. For example, one of the biggest differentiators in tech has been the emergence of hyperscale platforms with winner-takes-most economics. It is not surprising, therefore, that the biggest winners during the pandemic (in terms of stock market performance), including both established hyperscale-technology players as well as fast-growing players such as Zoom and Square, have invested in these technology platforms.

For most companies, though, aspiring to own a global-scale technology platform may prove a less-than-viable pathway. So while the increasing emphasis of your capital investment should be on digital and technology assets, be sure to focus it on investments that provide not only a clear source of differentiation but also a winnable one. In the world of payments, for example, even large regional banks—which have traditionally enjoyed the resources to out-invest their local peers—are now seeing their investment in payments products and technology dwarfed by global payments platforms like PayPal.

It can still be possible for local or regional incumbents to own critical elements of a future software-enabled business model or technology-platform landscape, but they'll need to be all the more selective about where to play, focusing on those elements for which local factors are crucial, and which are more difficult for global technology players to replicate. For example, Walmart operates the third largest online marketplace in the United States but still trails more global players (and digital natives), such as Amazon and eBay, by some distance. As it seeks to close the gap, Walmart can leverage its huge physical store network to attract vendors wanting to offer customers in-store pickup and returns and shorter delivery windows. Other local incumbents have shown that partnerships across industry players can enable them to shape key technology platforms to compete with global tech companies. Nordic banks, for example, have partnered to create instant-payment platforms that have helped them defend their share of consumer payments in the face of global tech entrants.

At the same time, the emergence of global-scale technology platforms makes it easier for subscale or local players to compete. A growing number of companies are leveraging these platforms to build and deliver new software-enabled business models of their own by accessing world-class technology solutions via standardized, cloud-based, third-party solutions. For example, cloud computing relieves smaller companies of the need to invest in the fixed costs of data centers. Now, even the smallest start-up can access the computing power and storage of Google, Microsoft, or Amazon. In so doing, they reduce capital investment in less-differentiating areas and invest instead in the technology assets and capabilities that provide an edge over competitors—and through which they have the ability (and sufficient scale) to be distinctive.

One bank began spending smarter during the pandemic by deploying agile teams to stand up minimum viable solutions to challenges in digitization and technology infrastructure. Rather than shelling out hundreds of millions of dollars to replace core technology systems (such as the systems of record that track loans and other transactions), the bank wrote a bit of code into its new cloud stack to digitize (and automate) data capture around credit risk factors, and combined that minimally viable product with an agile team connecting bankers with risk and compliance specialists. The approach yielded faster, better decisions at a fraction of the cost and time—all while transforming the customer experience. Working smarter avoided (or at least deferred) a massive spend on underlying core systems, enabling the bank to redirect these funds into more productive investments, such as an AI-based credit-decisioning algorithm that lowers credit risk while improving customer experiences.

Building a new digital business or fully revolutionizing an existing one is hard, and the pitfalls are many: it can be easy to waste money in digital and technology if leaders are not sufficiently informed regarding their business's value drivers. A thorough assessment can help companies examine their own technology spending relative to peers, the better to understand where they might need to modernize IT operations to support accelerated digital strategy. A case in point

Tech-enabled leadership

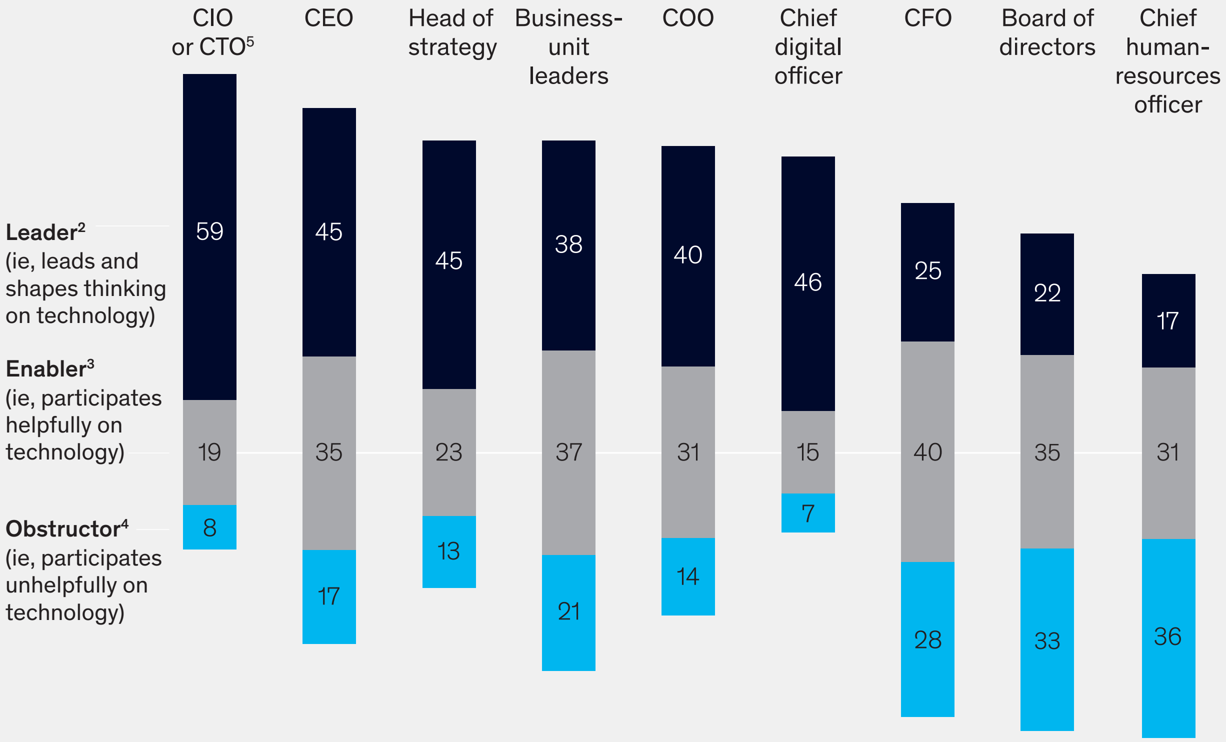
Outperforming through digital requires a high level of tech savvy, not just from technology leaders within the organization but from the entire leadership team. Responsibility cannot fall solely on chief information officers (CIOs) and chief data officers (CDOs). Business-unit leaders and COOs are increasingly being asked to make tough trade-offs between technology and other types of investments. Executive boards, for their part, now need a broader technology fluency across all board-level decisions, rather than simply a single, siloed "tech expert" board member.

Yet, as of today, too few company leaders have engaged deeply with technology, even as it transforms the requirements of nearly every role and becomes part of everyone's job (exhibit). Without a deeper understaning of the critical intersection points between their business and the promise of new technologies, executives and board members may struggle.

Exhibit

Across the leadership team, the call to become more tech savvy is urgent—even for roles that have typically engaged very little with technology.

Level of engagement, by role, % of respondents[1]



[1]Respondents who answered "don't know" are not shown; n = 1,140.
[2]That is, company leaders who are industry leaders in finding ways to apply new technologies or consistently identify how new technologies could change or transform the business and lead the implementation of these technologies.
[3]That is, company leaders who respond in a well-informed manner when others raise technology-related decisions.
[4]That is, company leaders who respond sporadically and not always in a well-informed manner in technology-related discussions or are not engaged at all in technology-related discussions.
[5]Chief information officer or chief technology officer.

is the cloud. McKinsey analysis shows that almost all industries across the Fortune 500 show potential for an average rise in earnings before interest, taxes, depreciation, and amortization (EBITDA) of more than 20 percent from the cloud, but an overly narrow view of the value the cloud can generate often keeps companies from making decisions that deliver the benefits that are possible. For example, blindly migrating workloads to the cloud in the anticipation of cost savings instead of thoughtfully deploying the cloud to enable innovation and differentiation at pace has contributed to 30 percent of companies reporting that much of their cloud spending currently goes to waste. Paradoxes like this further highlight the importance of achieving technology fluency throughout the top team (see sidebar "Tech-enabled leadership").

Lastly, given the rapid pace of change, a nimble approach to investment is also important. Agile, stage-gated investment practices help ensure spending gets committed on a performance basis and quickly reallocated if initial hypotheses don't bear out in the market.

Reallocate resources at digital speed

The link between active resource reallocation and value creation is well established: McKinsey research has shown that companies shifting more than 50 percent of their capital spending across their businesses over ten years created 50 percent more value than counterparts that moved resources at a slower pace. Dynamic resource allocation shifts money, talent, and management attention to where they will deliver the most value to your company.

But now companies need to reallocate resources at an even faster pace. What was considered best-in-class speed for most business practices in 2018 is now slower than average—thanks to the massive technology acceleration that has occurred since early 2020. Companies with the strongest technology endowments are moving at an even faster pace.

This effect was visible during the COVID-19 crisis as companies stood up working solutions for big changes, such as remote working, migration to the cloud, or last-mile delivery, all of which required rapid, dynamic resourcing to support innovative changes carried out in a matter of days or weeks rather than the one to two years most companies had previously thought necessary (Exhibit 3). As aptly stated by Microsoft CEO Satya Nadella in a 2020 quarterly earnings call, "We've seen two years' worth of digital transformation in two months."

At many companies, an effective response to the pandemic required reallocating capital and talent toward digital, even when other parts of the business were seeing broader cost reductions. These trends might not continue at the frenetic pace of the pandemic, but they are unlikely to return to precrisis norms, especially as barriers to improvisation and experimentation fall, along with the associated stigma of "failing fast." Fortunately, you don't need to predict the future when shifting resources. You just need to read the present moment better than your competitors and respond dynamically.

Get digital M&A right

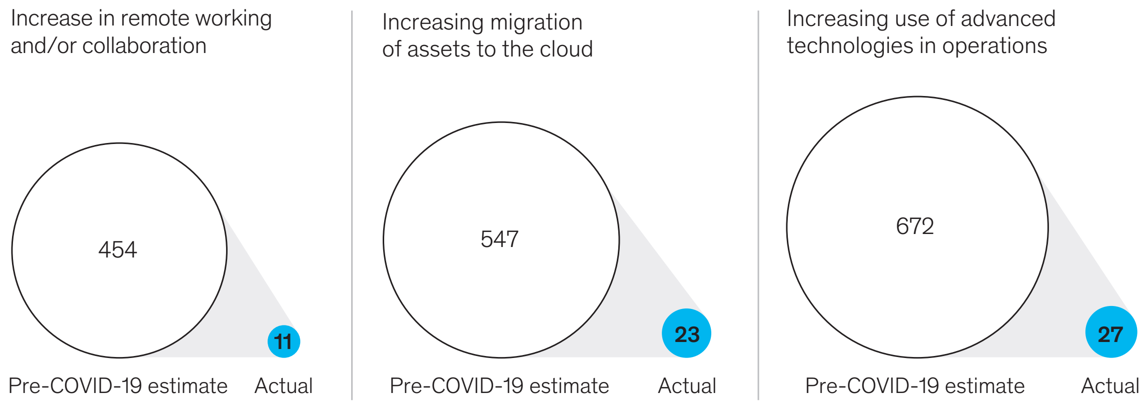
Differentiating through digital technology requires having the right capabilities, culture, and infrastructure. But companies can struggle to build these organically at sufficient scale and speed. That's one reason many companies instead look to acquire digital assets, skills, and talent through digital M&A (defined as the acquisition of a company with predominantly digital capabilities and revenue streams). Companies need broader exposure to the tailwinds of digital technology, and digital is thus often a predominant focus of their M&A activity.

But what is the right approach to digital acquisition? Across most M&A strategies, evidence shows that a programmatic approach (the steady acquisition of multiple smaller targets in a focused fashion over an extended time horizon) is the most effective one for companies hoping to jump up the power curve of economic profit. But programmatic M&A may not always be the best bet for digital leapfrogging—initially, at least. Our research indicates that the early acquisition of a "digital unicorn" (defined as a single deal worth at least $1 billion) has been a significant differentiator for total shareholder returns

Exhibit 3

The pandemic showed what organizations can achieve when the leadership and full organization commit to act.

Time required to respond to or implement changes, pre-COVID-19 estimate vs actual, number of days



(TSR) for big incumbent companies in the past ten years (Exhibit 4), even though this runs counter to what traditional programmatic M&A approaches would suggest.

Why make a big acquisition in the digital space when this strategy has typically been less effective for nondigital acquisitions? Because integrating many smaller tech companies, as would be required by the programmatic approach to M&A, can be much harder than integrating smaller, nondigital companies. The difficulties have to do with culture, talent, and infrastructure. Emulating the culture of a digital native (whether Amazon's famous "customer obsession," Netflix's "no rules rules," or the rapid product-development cycles typical in a native software company) can be challenging for large incumbent organizations that have strong existing cultures, as well as more structural-process and decision-making barriers to operating like a digital native.

Culture is a sticking point in any postmerger integration, of course, but even more so when incumbents buy technology companies with the hope of shifting their own culture toward that of a digital native with new talent and ways of working. Typically, there is a mismatch between the incoming talent and the cultural behaviors of the acquirer. This makes the traditional programmatic M&A approach, with its series of smaller deals, more difficult to pull off. If each deal is below critical mass for shifting the culture and ways of working of the combined organization, the smaller acquisitions can have a tendency to die on the vine once they are bought by corporate behemoths. Critical talent can be lost when individuals accustomed to more freewheeling cultures find themselves in more traditional organizations. And when talent walks, the culture the incumbent had hoped might be a transformative catalyst leaves with it.

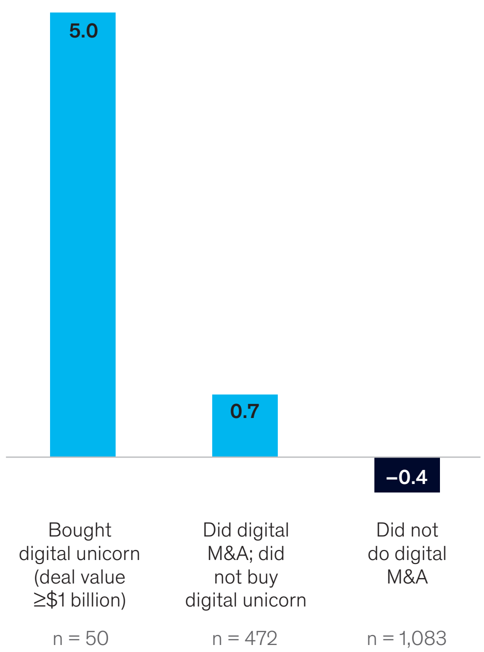
Furthermore, when it comes to organizational culture, every tech company is different. Incumbents that start off buying many small tech companies often end up with a piecemeal approach to integrating multiple unfamiliar cultures—cultures that may clash with not only the incumbent company culture but also that of the incumbents' other acquisitions.

These pitfalls seem less prevalent when incumbents acquire a large enough source of tech-friendly talent and culture up front. The

Exhibit 4

Companies that acquired a digital unicorn outperformed those that did not.

Median excess total shareholder returns (TSR), by number of digital deals,[1] 2009–18, %



[1]The difference between a company's TSR compared with the median TSR of companies in the same industry (based on Global Industry Classification Standard industry level 2).

sheer number of people that arrive with a big acquisition have an easier time protecting their culture and influencing their new parent company's established culture and operating model without being suffocated in the process (see sidebar "Making big-bang acquisitions work").

There's still another reason it may make sense for legacy companies to consider buying a digital unicorn: the need for well-integrated and coherent technology road maps and fit-for-purpose infrastructure to help transform entire business domains within their companies, not merely deliver individual use cases. To get there quickly, it often makes sense to acquire the needed infrastructure all in one go, rather than trying to integrate smaller acquisitions, each with varying technology platforms that can be made interoperable only after the fact.

Of course, a big acquisition isn't always the right answer, and a large digital acquisition doesn't magically modernize your technology function or the tech stack it relies on. The best tech transformations occur in organizations that tackle multiple interdependent elements spanning the technology function's role, delivery model, and core systems—all with a properly sequenced migration path. In this modernization process, a new acquisition, which might often bring a more cloud-enabled technology stack, sometimes provides a lifeboat, so to speak, that helps companies transition from outdated tech stacks toward the more nimble cloud-enabled stacks they need.

That said, once an incumbent company has acquired and successfully assimilated a digital unicorn—and made the necessary shifts in culture, ways of working, and technology architecture—the advantages of taking a more programmatic approach to smaller acquisitions resurface. The organization is now in a fit state to pursue a more traditional M&A approach. In sum, companies looking for a better foothold in digital should consider whether it is best to make a larger acquisition up front to achieve a step change in culture, talent, and technology infrastructure before moving to a more programmatic approach thereafter.

Making big-bang acquisitions work

What about the risks that come with big-bang acquisitions like buying a digital unicorn? Here are some steps to make these large bets less daunting.

1. Clarify your intent
Clearly defining your strategic rationale in the context of a specific acquisition target helps ensure your big purchase will prove as relevant to your existing business as possible. Is your acquisition aimed at plugging a capability gap? Expanding your reach and relevance? Changing your company's DNA, including how and where you compete? Any of these objectives, or some mix of them, might be the primary rationale for a big acquisition.

2. Perform your technology due diligence
Some companies, in our experience, perform less technology diligence on acquisitions costing hundreds of millions of dollars than they do on internal pilot programs that cost a fraction of that. Performing deeper and broader technology diligence will help you understand how the acquisition target's different technology capabilities, systems, and platforms might interact (or not) with one another and those of your own company.

3. Integrate thoughtfully and quickly
Not only will you want a detailed integration plan with a specific eye toward technical talent retention and existing customer relations, you'll want to execute against it quickly and thoughtfully. Speed matters with any acquisition but all the more so with digital ones, since their products often sit adjacent to other products in an acquirer's portfolio. Any significant delay carries increased risk to the synergies built into the purchase price. Furthermore, acquirers that take too long to integrate their purchase sometimes miss the opportunity to transform their organizational culture in time to prevent newly acquired talent from walking out the door. Slow movers also risk migrating too gradually to their new tech stack. Instead, they end up with two parallel stacks operating side by side at great cost—and with considerable confusion to users.

4. Create a digital M&A playbook
For both a big initial acquisition and more programmatic ones thereafter, you'll want an operating model for digital M&A. Your goals are to establish strong governance and accountability; design clear roles and assign them to the right people, along with the right tools; build your capabilities and reputation as an acquirer; and create a compelling narrative for investors.

Many companies, stunned by how quickly digital technology moved center stage during the pandemic, have scrambled toward rapid digital transformations. We'd be the last to discourage this urgency. But companies should also step back to reassess their strategies thoroughly and carefully in the light of digital disruption and digital opportunities. The fundamental strategic principles still apply—as do the bold moves proven to boost corporate performance—provided you keep a close eye on how digital is reshaping them.

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How boards have risen to the COVID-19 challenge, and what's next

According to a new survey, the COVID-19 crisis has accelerated operational changes and stronger collaboration between directors and management that are key to a board's success.

For more than a year, the COVID-19 pandemic has disrupted and challenged organizations, lives, and livelihoods across the globe. The results from a recent McKinsey Global Survey of more than 800 board directors and executives confirm that while overall corporate performance has suffered during this time, boards were quick to rise to the challenge of navigating a global public-health *and* economic crisis.[1] That is especially true with regard to how boards operate; after many years of reports of only minimal improvements in how they work and their overall effectiveness,[2] the latest results suggest that the pandemic has triggered new and improved ways of working that may outlast the pandemic.

One such improvement is the collaboration between the board and management, which in many organizations has increased significantly during the crisis. Boards have also implemented new structures and processes, become more flexible in their agenda setting, doubled down on strategy, focused on corporate resilience, and, at the director level, committed more time to board-related work. Whether these changes—in particular, a more seamless relationship between the board and the management team—will remain after the pandemic is not fully clear. But when we look at the responses from boards that were most adaptable and effective in helping their organizations navigate the crisis, a few lessons emerge for what boards should do to maintain the positive momentum.

Boards before the pandemic

Our survey results from just before the COVID-19 crisis suggest the extent to which the pandemic caught organizations—and their boards—off guard. A few months before the initial outbreak in China, less than half of all respondents in our 2019 survey said that corporate resilience (for example, the ability to manage a downturn) was on their current board agenda.[3] And in 2019, only one-fifth believed that a lack of corporate resilience was a significant challenge for their organizations. Among respondents who said resilience was a challenge, nearly half said their boards were unprepared to manage it (Exhibit 1).

Our latest survey asked about the most significant operational challenges facing boards when the crisis began, and directors tend to say that their own boards had few established processes in place to guide them during the pandemic's early days (Exhibit 2). After the lack of in-person interactions and difficulty with remote-working tools, the most common challenges—a lack of crisis-management processes, the blurring of roles between the board and management team, and a lack of relevant capabilities within the board—suggest there were some early challenges to adapting the board's operations in a crisis environment.

At the same time, this environment created a unique opportunity for board directors to step up their game and provide critically needed guidance to their organizations by adapting decision-making processes and lending their crisis-management experience while in some cases also battling for the company's survival.[4] And the survey results suggest they have done just that.

Boards responded to the crisis—and quickly

According to the survey, boards have largely answered the call to help their organizations govern through crisis. To start, directors increased their overall time commitment. Between 2019 to 2020, respondents report a nearly 20 percent increase in the average number of days spent on board work, and they expect to increase their time spent even further between 2020 and 2021. Among directors who say their boards have been very effective at helping the organization respond to the crisis, they

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[1] The online survey was in the field from September 15–25, 2020, and garnered responses from 846 participants representing the full range of regions, industries, company sizes, and board roles; of them, 417 were board directors and 429 were C-level executives. To adjust for differences in response rates, we weighted the data by the contribution of each respondent's nation to global GDP.

[2] "Governance since the economic crisis," July 1, 2011, McKinsey.com; "Improving board governance," August 1, 2013, McKinsey.com; "Toward a value-creating board," February 1, 2016, McKinsey.com; "A time for boards to act," March 26, 2018, McKinsey.com.

[3] The 2019 online survey was in the field from August 1–16, 2019, and garnered responses from 1,304 participants; of them, 1,041 were board directors and 263 were C-level executives.

[4] Martin Hirt, Celia Huber, Frithjof Lund, and Nina Spielmann, "Boards in the time of coronavirus," April 16, 2020, McKinsey.com.

Exhibit 1

In 2019, corporate resilience ranked low on the board agenda—and for boards that saw it as a challenge, few were prepared to manage it.

Topics on the board's 2019 agenda,[1] % of respondents

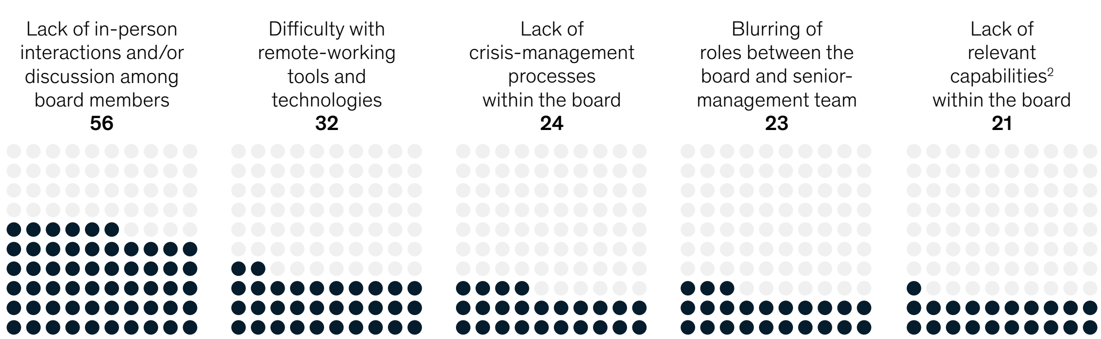
How prepared boards were in 2019 to manage a lack of corporate resilience within their organizations,[2] % of respondents

[1]Out of 15 agenda topics that were offered as answer choices.
[2]Question was asked only of respondents who identified "lack of corporate resilience" as a significant challenge that their organizations were facing; it was cited by 22%. Respondents who answered "don't know/not applicable" are not shown, so figures do not sum to 100%.

Exhibit 2

At the start of the pandemic, boards had few established processes in place to guide them.

Most significant operational challenges for boards when the COVID-19 crisis began,[1] % of respondents



[1]Out of 11 challenges that were offered as answer choices. Question was asked only of board members, n = 417.
[2]For example, digital expertise, transformation experience, crisis-management skills.

already spent significantly more time than others precrisis—and now report much greater increases in their time spent on board work (Exhibit 3).

Implementing new structures and processes
Besides the increased time investment, the results suggest that nearly all boards made at least one change to their operating models to better manage the crisis (Exhibit 4). The most common change has been structural: investing in technology and tools to enable more digital collaboration and establishing ad hoc crisis committees. After that, directors most often cite changes to the ways that boards and management teams work together and the flexibility of their agendas. Among the least common changes so far have been to board composition—though perhaps not surprisingly, since adjusting the diversity of skills, demographics, or geographies represented on a board is a more complex change to make than others and also requires shareholder approval (see sidebar, "How to diversify your board of directors").

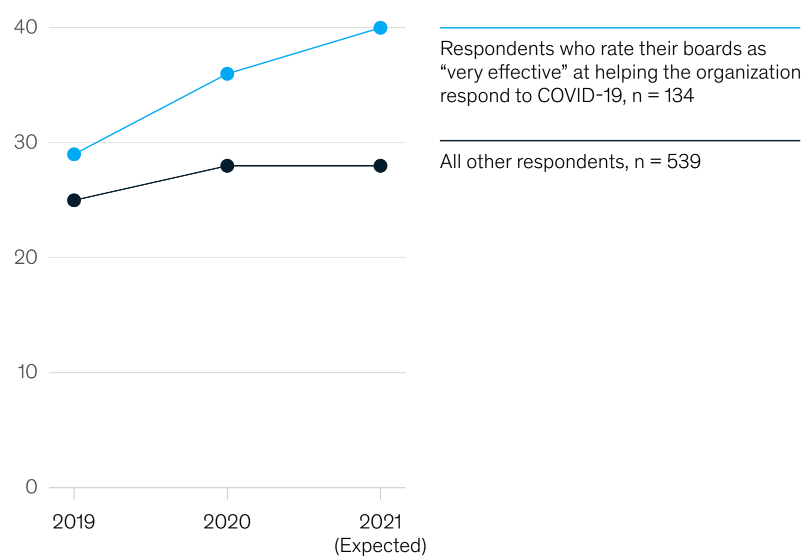
Strengthening collaboration with management
According to the results, the pandemic appears to have triggered changes that, in past surveys, board directors cited as the best ways to improve their collaboration with senior management as well as the effectiveness of board meetings. In our 2019 survey, more than half of all respondents said that more constructive boardroom discussions between the board and senior-management team would most effectively improve their collaboration.

Indeed, better discussions and collaboration between the board and management team are

Exhibit 3

Directors have increased their overall time spent on board work, especially those reporting a 'very effective' response to the crisis.

Days per year board directors have spent on board work,[1]
number of days



[1]Including board and committee meetings, preparation, training, and informal contact with the organization.

Exhibit 4

Nearly all boards made at least one change to their operating models to manage the crisis.

Changes made by the board since the COVID-19 crisis began,[1] % of respondents

Change	%
Structural changes	
Invested in technology and/or tools to enable more digital collaboration	45
Established an ad hoc crisis-management committee	25
Implemented new crisis-management processes	24
Significantly increased the responsibilities of its standing board committees	14
Created new board committee(s)[2]	11
Process changes	
Increased the frequency of interaction between the board and management between meetings	37
Increased flexibility in the board's agenda	37
Included strategy as a topic on every board meeting's agenda	35
Implemented changes to existing board processes	34
Strengthening collaboration	
Strengthened collaboration between the board and senior-management team	36
Strengthened collaboration between the board chair and CEO	27
Realigned the board and management team around a shared vision for the company's future	23
Realigned responsibilities between the board and senior-management team	19
Improved team dynamics among members of the board	18
Adjusting board composition	
Increased the diversity of the board's skills and/or capabilities	12
Increased the board's demographic and/or geographic diversity	8

[1]Question was asked only of board directors, n = 417; respondents who answered "none of the above" (8%) or "don't know" (1%) are not shown.
[2]That is, other than the ad hoc crisis-management committee.

Directors have largely stepped up during the pandemic, improving collaboration, implementing new processes, focusing on resilience, and spending more time on board work.

How to diversify your board of directors

At least in the near to mid term, we expect that most boards will continue to maintain a hybrid approach to their meetings, which loosens the requirement for directors to travel on-site for each meeting. The newly gained comfort with remote meetings—and evidence that they can be run well virtually—opens up a much larger pool of talented potential directors with relevant experience and insights that are in line with the strategic needs of a corporation (for example, geographic diversity) even if they are far removed from a company's geographic headquarters. These changing norms for meetings also give many boards the opportunity to diversify in several ways beyond geography—including social criteria and industry or topic-area expertise. We would strongly urge boards to start reviewing their diversity with respect to these issues: for example, seeking new members with experience operating in crisis mode who can effectively contribute to a broader scope of activities beyond traditional board responsibilities, such as workforce capabilities and sustainability. And beyond the composition of the board itself, boards should also explore ways to tap external advisers for their advice on rapidly evolving situations in a more systematic way than they may have done before the pandemic.

among the most common changes made during the crisis. What's more, 79 percent of respondents—including directors and C-level executives—say the collaboration between these groups has been effective or very effective during the pandemic, up from two-thirds who said so in 2019. And better collaboration correlates with a more effective COVID-19 response, according to the results: more than 90 percent of respondents reporting an effective collaboration between the board and management also say their board's response to the crisis was effective—compared with only 60 percent of all other respondents (Exhibit 5).

Creating a more flexible agenda

Over the past ten years, our research suggests that at a high level, boards have consistently focused on strategy over other items on their agendas, even throughout the crisis. Yet in a situation as extraordinary as the COVID-19 pandemic, respondents do report changes to more detailed topics on their agendas, and that an annual process for setting strategy—which was a long-standing norm for many boards in the past—is no longer sufficient. In the survey prior to the pandemic, only half of all board respondents said their boards were effective at either assessing whether their strategy accounts for new or emerging risks or adjusting the strategy continuously, based on changing conditions.

Here, too, boards have adapted in response to the crisis. Two of the top five changes respondents say their boards have made relate to the flexibility of their agendas: to discuss topics as they arise and to include strategy on the agenda of every board meeting—of which there were nine on average during 2020.

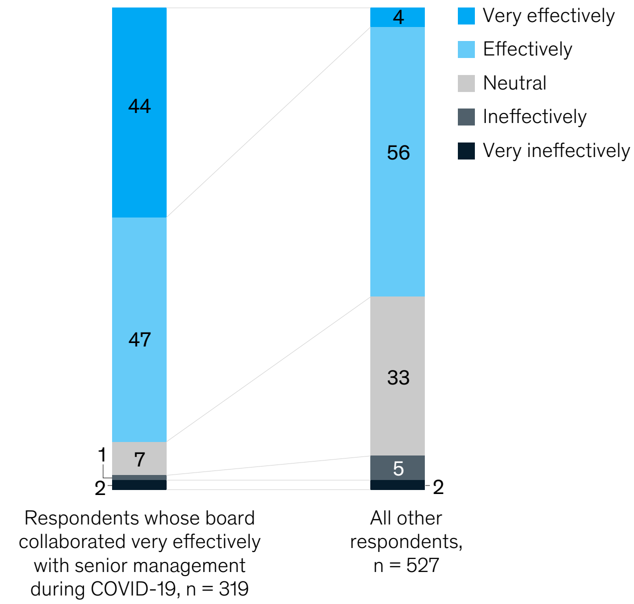
Increasing the focus on resilience

Compared with the results from the previous survey, respondents report a clear shift in the specific topics on their agendas (Exhibit 6). In 2019, boards were most focused on innovation and growth as well as technological trends. Innovation and growth remains the most common agenda item in the latest survey—though corporate resilience has risen in the ranks and become an almost equally important topic. And while boards seem to have shifted away from several people- and organization-focused topics (for example, the organization's culture, purpose, societal trends and changes, and workforce capabilities) in the past year to focus on their crisis responses, slightly larger shares of directors say such topics will be on the 2021 agenda.

Exhibit 5

Better collaboration between boards and management teams seems to have supported a more effective COVID-19 response.

Effectiveness of boards in helping the organization respond to the COVID-19 crisis,[1] % of respondents

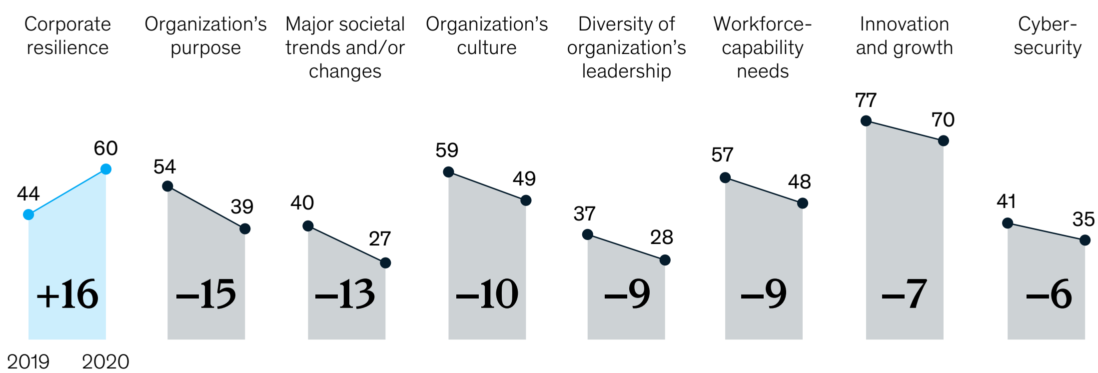


[1]Figures may not sum to 100%, because of rounding.

Exhibit 6

Compared with 2019, respondents report a clear shift in the topics on their boards' agendas.

Topics on the board's current agenda,[1] % of respondents



[1]Out of 15 topics that were offered as answer choices. 2019, n = 1,041; 2020, n = 846.

Learning from the most adaptable boards

To get an even better understanding of the changes under way, and which of them might outlast the crisis, we took a closer look at responses from the most adaptable boards and the changes they made across structural, process-related, and interpersonal dimensions (Exhibit 7).[5]

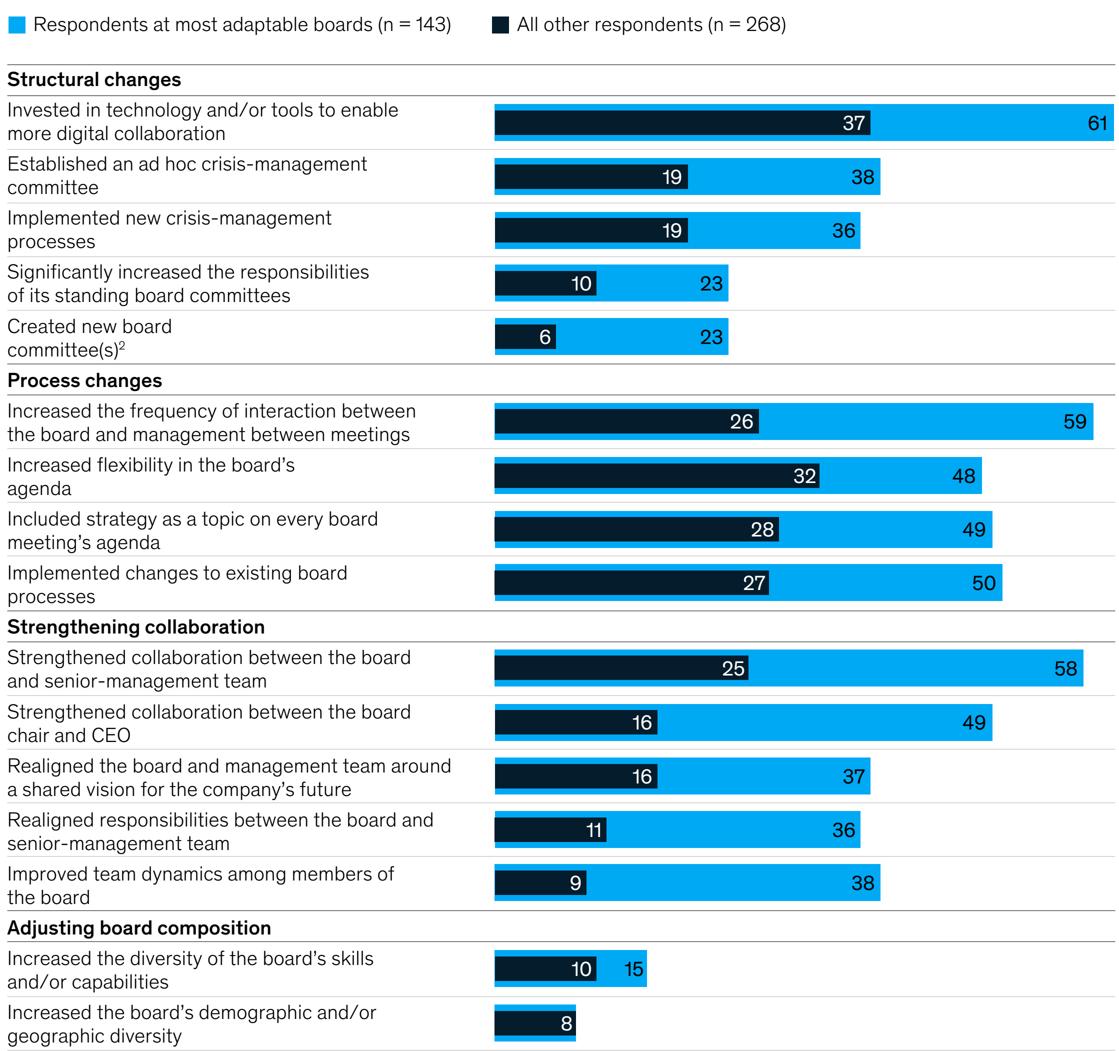
On average, respondents on the most adaptable boards are twice as likely as others to report any of the operational changes we asked about once the crisis had started. The biggest differences between the most adaptable boards and all others relate to collaboration between the board and senior management, as well as collaboration within the board. And compared with all other respondents, a

[5] We define "adaptable boards" as boards whose respondents report at least one structural change, one process change, and one change to collaboration on their boards since the COVID-19 crisis began *and* boards that have been effective at helping the organization respond to COVID-19 (n = 143). This analysis included only board directors and not respondents who identified as C-level executives and answered on behalf of their own company's board.

Exhibit 7

The most adaptable boards were much likelier than others to implement a range of structural, process, and interpersonal changes.

Changes made by the board since the COVID-19 crisis began,[1] by type of board, % of respondents



[1] Question was asked only of board directors; respondents who answered "none of the above" or "don't know" are not shown.
[2] That is, other than the ad hoc crisis-management committee.

Innovation and growth remains the most common topic on the board agenda—though corporate resilience rose in the ranks and became an almost equally important topic.

significantly larger share of directors at the most adaptable boards say their boards' decisions and activities have a high or very high impact on the organization's value creation during the crisis.

When looking closely at this group's responses, we see that they report significantly better performance on a number of other dimensions:

— *Time commitment.* At the most adaptable boards, directors reported the same average number of meetings in 2020 as did their peers on other boards. Yet their overall time spent on board work is much greater: these directors report a 50 percent higher number of days spent on board work in 2020, compared with all others. And while this group expects to spend one less day in 2021 than they did last year, that number (37 days) is still much higher than the days expected by all others (27 days).

— *The board's agenda.* According to respondents, their boards allocate a similar amount of their meeting time to specific topics (such as strategy, risk management, and finance[6]) as they did in 2019; but risk management has moved up in the overall ranking of topics, and boards now spend as much of their time on it as they do on organizational issues, such as talent management, organizational structure, and culture. Yet respondents at the most adaptable boards report slightly different priorities: for example, they spent significantly less of their time on performance management than others. When looking at specific topics, the most adaptable boards appear to be faster at changing their agendas to meet the moment. According to directors on adaptable boards, they are much more focused on corporate resilience than their peers (69 percent say it's on the agenda, versus 54 percent), and they are almost twice as likely as others to cite disruptive business models. Fast forward one year, and the most adaptable boards expect the biggest increases in their focus on the organization's purpose; political, geopolitical, and macroeconomic risks; and the effects of climate change.

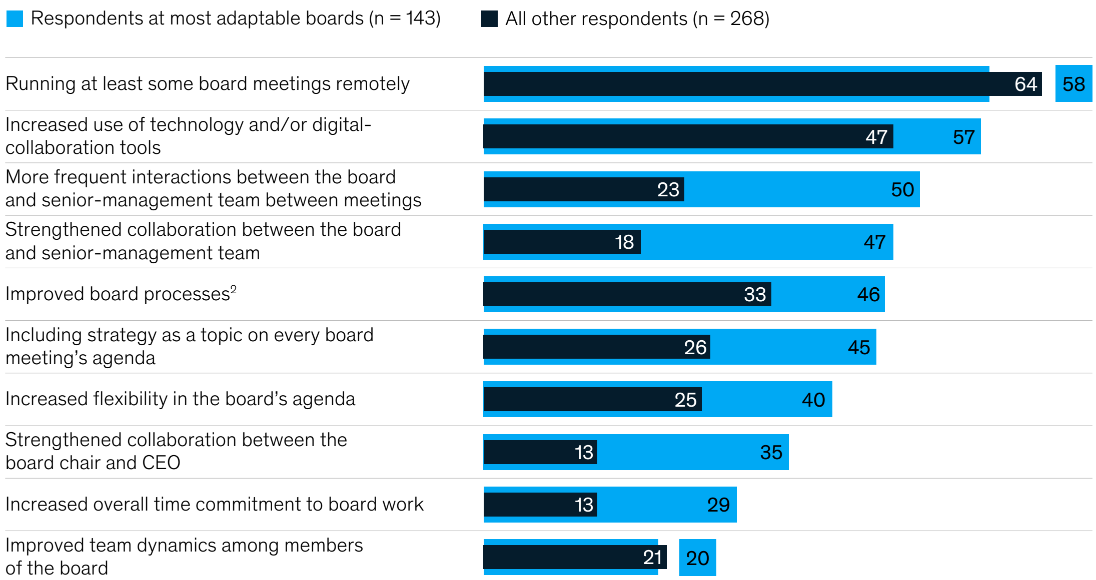
— *A new way forward.* Finally, the more adaptable boards are more likely to stick with the newer ways of working in the long term (Exhibit 8). Of 15 changes to the ways boards work, much larger shares of the adaptable directors say their boards will continue with eight of them; most notably, they will continue with changes that signal increased value-enhancing board involvement, rather than merely rubber-stamping decisions—for example, including strategy as a topic on every meeting agenda, strengthening collaboration, and increasing interactions between boards and management teams in between meetings. Indeed, almost 90 percent of respondents at the most adaptable boards say their collaboration with senior management was effective or very effective during the crisis.

[6] The survey asked about the following topics and how respondents' boards allocate their time to each one during their meetings: strategy; performance management; finance and accounting; risk management; organizational structure, culture, and talent; investments and M&A; core governance and compliance; and shareholder and stakeholder management.

Exhibit 8

Over the long term, adaptable boards are more likely to stick with many newer ways of working.

Changes to a board's ways of working that are most likely to remain over the next 3 to 5 years,[1] by type of board, % of respondents



[1]Out of 15 changes that were offered as answer choices. Question was asked only of board directors; respondents who answered "none of the above" or "don't know" are not shown.
[2]For example, more frequent updates on company insights, shorter reports.

In other ways, the adaptable boards and others are aligned on how boards will continue to evolve. Both groups of respondents agree on the most likely changes: their boards will continue running at least some meetings remotely (62 percent of all respondents say so), and their use of technology and digital tools to collaborate will increase (50 percent).

While it's not clear yet which of the substantial changes that boards made during the COVID-19 crisis will continue to gain momentum, there is a general consensus that the ways boards work in the future will look quite different. Based on our experience, boards can keep the momentum going and serve as catalysts for change by doing the following: taking a more flexible and agile approach to agenda setting, which will help boards account for timely or emerging topics (for example, corporate purpose and environmental, social, and governance issues), new risks to the business, or strategic alternatives as the need arises; dedicating their additional time spent on board work to value-enhancing activities outside of formal meetings (for instance, prereading of materials; attending training and development sessions; or participating in one-on-one meetings with other board directors, key executives, or other company stakeholders); and interacting more often with the executive team through formal and informal one-on-one interactions. For instance, having the chair of the audit committee coach the company's CFO.

The survey content and analysis were developed by **Celia Huber,** a senior partner in McKinsey's Silicon Valley office; **Frithjof Lund,** a senior partner in the Oslo office; and **Nina Spielmann,** a senior expert in the Zurich office.

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The role of boards in fostering resilience

The lessons learned from the current crisis can help corporate boards strengthen the organizations they serve.

Boards of directors play a critical role in ensuring that management is well prepared for a wide range of potential shocks. In the fourth episode of our series on board perspectives around the most important issues facing organizations, the *Inside the Strategy Room* podcast looks at the role that boards play in building resilient companies. Frithjof Lund, who heads our board services work, leads a discussion with Gordon Orr, a nonexecutive member of several companies' boards and a McKinsey senior partner emeritus, and Martin Hirt, the global co-leader of McKinsey's Strategy & Corporate Finance Practice. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, you can listen to the episode and subscribe to the series on Apple Podcasts, Spotify, or Google Podcasts.

Frithjof Lund: If there has ever been a year when corporate resilience was tested, it was 2020. Martin, you have led a lot of our research on resilient companies. What does resilience mean in this context?

Martin Hirt: Broadly speaking, resilience refers to a company's ability to weather a crisis well. That means being prepared to deal with an unforeseen event such as an accident or, more commonly now, a major global health or economic crisis.

Gordon Orr: I don't think resilience is only about unforeseen events. As boards, we would not criticize ourselves for failing to anticipate a pandemic in 2020, but for not having included in our portfolio of potential risks something that would have the kind of business impact that COVID-19 has had and developed the key actions to take.

Martin Hirt: I would concur: resilience is about preparing for both unforeseen and predictable crises. Companies aware of how various types of events would affect their economics are generally better prepared. That is what drove our research. We looked at how organizations fared during previous economic crises and defined resilient companies as those in the top 10 percent of shareholder return outperformance through and after the crisis. We tried to understand at a very granular level what these companies did that differed from others and how those actions played out over time.

Gordon Orr: The share price metric is clearly critical, but assessing how well a board or management perform during a crisis has to encompass externalities, not only preparedness and actions taken midcrisis. During this crisis, share price changes of the companies on whose boards I sit have ranged from a 50 percent decline to an increase of 200 percent, and the biggest difference has been the nature of demand. An airline flying out of Hong Kong is now more than a year into demand at 1 percent of historic levels, whereas a manufacturer of PCs has seen the highest demand for its products in years. The resilience challenge at the computer manufacturer has been about ensuring the supply chain works, whereas for the airline it was more about balance-sheet resilience.

Martin Hirt: So it makes sense to differentiate between the actions companies take before a crisis strikes to prepare themselves where the timing is uncertain, and the actions they take once these externalities hit.

Gordon Orr: I agree. Shareholders tend to see the board's annual enterprise risk assessments as tick-the-box exercises to meet stock exchange requirements. But if they are done well, they are foundational elements of being prepared, because you discuss the range of risks the organization faces and how those risks play into the financials. The overarching takeaway from that process is often, "Do we have enough capacity in the balance sheet to deal with the shock?" At crisis time, it is too late to start paying attention to the balance sheet. You have to have been thinking about that in advance.

Martin Hirt: There is an additional layer of how the board engages with management so the needed actions are taken. In about 2006, we worked with a large Australian real-estate company whose board had asked us to help them think through how their economics, balance sheet, P&L [profit and loss], and cash flow could be affected by certain events. After the financial crisis, in about 2010, they told us they only implemented half of the recommendations. They said, "In hindsight, we wish we had done everything because what we did do saved us."

Gordon Orr: Well, the development of the risk map and plan is not done in isolation of management. In fact, management and the risk team do the heavy lifting and we, as the board, stress-test. A particular challenge we had this year is that it wasn't just the COVID-19 crisis—we also had a geopolitical and social stability crisis. Over the past four or five years, companies have been facing increasing levels of geopolitical risk, particularly in the technology space, and some of those issues have intersected with COVID-19 around market access and security of supply. Multiple dimensions are amplifying the effects of the pandemic and each other, and increasing the chance of something that might have been incremental turning into a major discontinuity.

Frithjof Lund: At what point and how should a board intervene to ensure the company is developing resilience?

Gordon Orr: That generally is first debated in depth in the audit and risk committee, working with the finance team and the strategy team. That is then synthesized and elevated to the full board for discussion to stress-test and challenge. In crises, the dynamic between the chair and the CEO becomes incredibly important because they talk several times a week and then inform the board, shareholders, and potentially get the board together to make decisions. Do we reach out to the governments for support? Do we need to communicate with investors? Do we need to resize a business significantly? As a board member, this is the moment when you show up. This is what a high-

'Shareholders tend to see the board's annual enterprise risk assessments as tick-the-box exercises to meet stock exchange requirements. But if they are done well, they are foundational elements of being prepared.'

–Gordon Orr

quality board member prepares for because these are difficult decisions you have to make quickly.

Martin Hirt: One important resilience factor we have seen, especially in this pandemic, is how quickly companies shifted their operating model at the top—how they collaborate, how they make decisions and at what pace, and how they support those processes with war rooms or teams providing a synthesized version of external information, structured into scenarios so decisions can be taken confidently. In your experience, what role does the board play in triggering those operating-model changes, Gordon?

Gordon Orr: The judgment between acting too fast or hanging on in the hope that things turn around is tough. The board's role, at a first level, is to be a counterweight to what management proposes: Why are you saying "A" when the opposite of "A" is equally valid? Secondly, the board has to stand back and take a strategic perspective because management is likely doing firefighting at this point. The board should ask, "Will things ever get back to the way they were before? What does the post-COVID world look like? Will the business model we used ever come back?"

Martin Hirt: One of the big insights we had from working with hundreds of corporations during this crisis is that, especially when uncertainty is extremely high, not just focusing on firefighting (although firefighting is important) and not just focusing on the long term but focusing on key decisions along the entire timeline is crucial. I found, for example, that many teams struggled to decide whether to accept stimulus, because many companies that had been quick to accept government support during the financial crisis started regretting it within months because it came with big strings attached and getting out of it was not easy. That is one example of a decision that has to be taken in two or four weeks' time but has potentially multiyear implications.

Other critical decisions, of course, are related to employee health and safety. Then come the decisions about resource reallocation. One interesting insight from our research was that before and at the start of the last crisis, resilient companies divested 50 percent faster than their peers. They were willing to accept lower asset prices in order to create liquidity or make new acquisitions that repositioned them ahead of trends in order to come out of the crisis in a better position.

Frithjof Lund: You have talked about what boards should do, but what are the big pitfalls boards should avoid? Some boards, for example, made fairly high demands for information updates in the early stages of this crisis.

Gordon Orr: It has been very helpful for boards to get more information. The board and management need to have a common understanding of the most important information and at the right level of detail. For me, that means a dozen key performance metrics that tell you the input volumes and demand and how the company is addressing externalities, and getting that information weekly. It is already going to management so just add a few more people to the distribution list. And yes, recognize that when we get back to normal, returning to the monthly rhythm of information sharing will be fine.

Martin Hirt: The information sharing is an interesting one. It builds on the points we discussed earlier about the way boards and management teams look at key decisions during a crisis and the timeframes they consider. One of the differentiators we see is how well management teams use scenarios. It starts with the number of scenarios. If you have three or five, I would say you are operating in one scenario. You need to have an even number [so you do not naturally gravitate to the middle scenario], and structure the information in such a way that management and board directors don't have to start every conversation with a lot of context setting but are operating in the same frame. Updating those scenarios with the latest information, on the basis of a set of assumptions understood by everybody, is foundational. Once boards and management teams are on the same page, decisions can be taken very swiftly.

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–Martin Hirt

If there is information asymmetry—which scenario are we operating in and what does it mean?—it causes misunderstandings. In a crisis, there is a huge premium on decision speed and accuracy. In the military, the team that prepares the information and feeds it in a consistent way is called a plan-ahead team. It is different from the crisis management team, which is taking actions, executing decisions, reacting tactically in the field. The plan-ahead team sits next to the decision maker and its only function is to take information from all sources of intelligence and work it into these scenarios.

We have learned a lot about how these teams work best. For example, you should structure them around issues so when a decision comes at you—Do we take government stimulus? Do we ramp down our process-intensive operations that will require a long ramp-up time later?—it flows to that team and around these decisions the scenarios are applied. You have a structure that feeds decision-ready information to the board and the management team.

Gordon Orr: On the teams point, effective boards now are working as teams, and it helps if the large majority of board members have been together for a while, with an understanding of the business, the industry, management, the level of trust in each other that the synthesis coming up to the full board is of high quality. The orchestration by the chairman as the team leader becomes very important, particularly as you shift to virtual meetings. Members who joined the board recently and lack the experience of going through multiple balance-sheet cycles with management become a challenge for that team dynamic.

Martin Hirt: In order to be an effective team, people have to be trained. How does the board’s operating model change during a crisis, Gordon? What type of capability building and preparation have you seen be effective?

Gordon Orr: Skill building and training is another one of those things investors think boards do to tick the box. But boards do it because they want to get better. When you look at digital, for example, the board needs to be smart enough to challenge management. There are various ways of addressing that, such as an expert talking to the board. It could shape the decision on where we hold board meetings. If we want to understand the Indian market better, the board can spend time there as a group. It would be a red flag to investors if boards were not conducting a regular program of skill development.

Frithjof Lund: In terms of the chair’s role and the new dynamic between management and the board, how much of that do you think will persist beyond the crisis?

Gordon Orr: The role of the chairman has become much more time consuming and that may stay in the form of outreach to investors, governments, and other stakeholder groups. Many countries are piling more and more responsibilities on the board, which is becoming a challenge. Environmental, social, and corporate governance [ESG] is an enormous new topic in terms of board time. Cybersecurity is another. Being a board member is not a full-time job but it is getting closer to that, particularly in Europe. You are asking people to show up for 12 board meetings a year, plus committees, and to do this for a fraction of the compensation they received before.

Martin Hirt: I would add an individual component. Now that boards and management teams have worked together through the crisis, there is a level of bonding and understanding each other. But management teams and boards change. The question is, will the insights that the board and management gained about the operating model during a crisis and how to shift to it quickly be institutionally preserved or will they have to be relearned?

Frithjof Lund: If we look ahead, what are the top things boards should ensure are in place to handle future crises?

Gordon Orr: If there is one thing to remember from our conversation, it is the importance of preparation across a broad set of potential risks. Second is to lean in to decision making. Taking them sooner is generally better. And because of geopolitical risk, avoid the small and risky investments: initiatives that could create value but are potentially highly risky, where you could get a disproportionate negative impact on the business in return for relatively small gains.

Martin Hirt: As we think about future crises, we should not forget that we are still in this one. There is still a lot of uncertainty. We have seen in China that when the virus is domestically under control, economic activity jumps back, uncertainty drops, and economic growth returns to previous levels, if not higher. It is also relatively clear that the recovery will happen sometime in late 2021 or first quarter of 2022 for most countries that have been ahead of the game in ordering vaccines. Where the uncertainty remains high is how long the stimulus will continue. After the financial crisis, some governments cut off the stimulus too quickly, which stifled their economies. If that happens now, we could see a wave of bankruptcies and financial difficulties coming toward us.

But what I would stress from a board perspective is that the trends that have been accelerated through this crisis are almost certain to stay. The question is, are you acting on the writing on the wall? Traditionally, one of the most difficult things for corporations is reallocating capital and resources toward new initiatives. Helping the management team accelerate that process is absolutely critical right now.

Frithjof Lund: Aside from the stimulus ending too quickly, what sources of potential future crises should boards have on their radar?

Gordon Orr: Geopolitics is not going away. ESG and the potential inability of businesses to keep up with the expectations of society and investors could cause major discontinuities. And third are the massively greater levels of government intervention in business and potentially the return of active industrial policies by governments in many sectors.

Martin Hirt: There is a longer-term issue we all have to reckon with, which is that stimulus has been given out at astonishing rates. Some may say, "When it comes to central bank accounting, you can just cancel the whole thing out." That may not be realistic for some governments. So how we deal with the bill from this crisis is a potential future crisis.

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