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# What matters most?

Five priorities for CEOs in the next normal.

September 2021



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# **What matters most? Five priorities for CEOs in the next normal**

How leaders can adapt to a very different future.

September 2021

# Introduction

Over the course of the pandemic, businesses have largely—and often successfully—adapted to new ways of working. They’ve also embraced digitization and reorganized their supply chains. All of this has been necessary, but it will not be enough. To prepare for the post-COVID-19 era, leaders need to do more than fine-tune their day-to-day tasks; they need to be ready and willing to rethink how they operate and even why they exist. To put it another way, leaders need to step back, take a breath, and consider a broader perspective.

The pandemic has both revealed and accelerated a number of trends that will play a substantial role in shaping the future global economy. In our conversations with global executives, they have identified five priorities for the next normal. Companies will want to adopt these five priorities as their North Star while they navigate the trends that are molding the future.

Take sustainability, the principle of producing goods and services while inflicting minimal damage on the environment. Many companies have taken earnest steps in this regard simply because they wanted to. In the very near future, however, doing so will be as fundamental to doing business as compiling a balance sheet: consumers and regulators will insist on it. In this context, sustainability needs to be done as systematically as digitization or strategy development because it will be an important source of long-term competitive advantage.

Or consider the cloud. Its potential has long been recognized, and now it is beginning to bring about real results in innovation and productivity. A second priority, then, is for companies to deploy the cloud for a good purpose. To do so, their people need to be “cloud literate”—that is, to have a keen sense of the cloud’s capabilities.

As ever, it’s the human element that makes the difference. Developing talent is therefore another priority. The organization of the future will not—or, at least, should not—look like the one that existed as recently as 2019. It will need to be more flexible, less hierarchical, and more diverse.

And faster. The pace of change is speeding up, and the landscape of business is more fluid than ever. The need for speed—a fourth priority—is therefore acute. But this speed needs to be sustainable. Businesses did remarkable things in the early months of the pandemic, fueled by adrenaline and a sense of urgency. In the future, speed needs to be embedded into the organization. To put it another way, speed is not just about revving the engine faster, but also about designing it to run more efficiently and intelligently.

Finally, leaders need to recognize that people want meaning in their lives and their work. Previous research has found that companies with a strong sense of purpose outperform those that lack one. And those who say they live their purpose at work are simply better employees—more loyal, more likely to go the extra mile, and less likely to leave. Purpose helps companies recognize emerging opportunities and connect with their customers. This, too, should be seen as a priority and a source of competitive advantage.

How these five priorities are implemented will vary from company to company; some will be more important than others, depending on the market. But we believe—and executives around the world with whom we have worked agree—that mastering these five priorities will substantially improve the odds of success.

Our entire collection of individual insights related to the next normal is at [McKinsey.com/thenextnormal](https://www.mckinsey.com/thenextnormal).

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# 1

# Center strategy on sustainability

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

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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—increasingly so in recent years.<sup>1</sup> 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 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.

## 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 lead 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 only to have a great sustainability strategy but also to have 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.

<sup>1</sup> Witold Henisz, Tim Koller, and Robin Nuttall, “Five ways that ESG creates value,” *McKinsey Quarterly*, November 14, 2019, McKinsey.com.

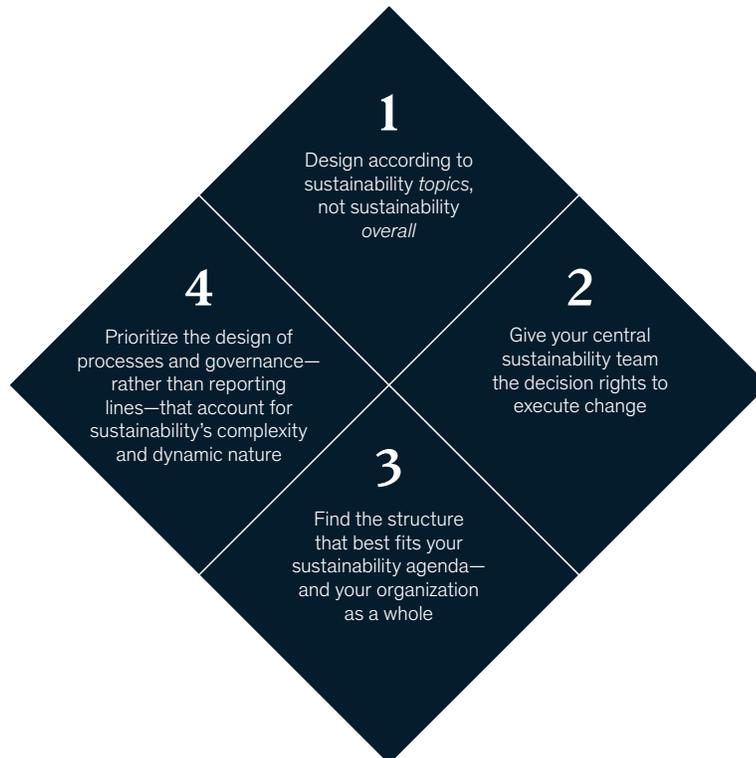
So how do executives build sustainability organizations that are well placed and empowered to help their companies meet stakeholders' increasing expectations, manage sustainability-related risks, *and* capture business opportunities? In this article, we outline four ways that leaders can guide the organizational 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 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,<sup>2</sup> 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.<sup>3</sup> 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.

### **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 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 can then come up with specific initiatives, timelines, and plans for pursuing those targets, and the central team can track their progress while also

<sup>2</sup> A materiality assessment is the process of identifying and prioritizing the 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.

<sup>3</sup> Audrey Choi, “The business case for investing in sustainable plastics,” World Economic Forum, January 20, 2020, [weforum.org](https://www.weforum.org).

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 become overstretched (especially if it's a small group) and have its attention diverted from specific priorities. Rather, cross-functional decisions and those that are highly material to the full company are best suited for central-team oversight.<sup>4</sup> 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.

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 is fully decentralized within business units, these three models help link sustainability to an overall strategy and give a sustainability organization real decision rights:

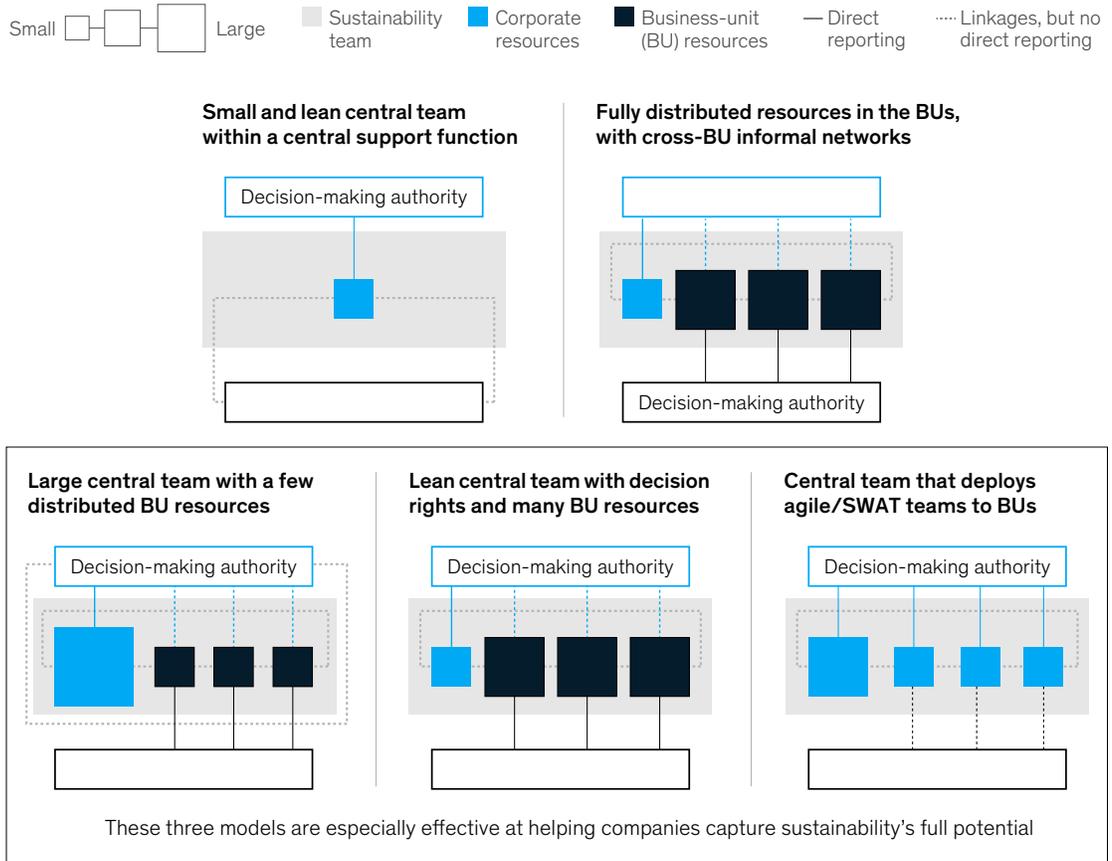
- **Large central team with few business-unit resources.** In this model, a large central team plans—and maintains the decision rights to—most sustainability initiatives and also coordinates with individual business units that are actively working on specific sustainability issues or have expertise related 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.

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<sup>4</sup> 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.

**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**



**Pros**

- Faster to elevate sustainability issues at corporate level
- Centralized target setting, planning, and tracking
- Consistent, cross-BU implementation of sustainability priorities

**Cons**

- Resource intensive for central team
- Less responsive to BU-specific priorities
- BUs not empowered to scale other BU-specific sustainability initiatives

- Faster BU-level response
- Empowered BUs receive clear central guidance
- Less resource-intensive for central team

- More speed and agility within BUs but not across BUs
- Significant resource commitment from BUs

- Central team controls corporate sustainability agenda and resourcing
- Agile resource deployment to meet evolving priorities
- Easy sharing of best practices and expertise across BUs

- Highly resource intensive for central team
- Sustainability driven from the top down, so BUs are not empowered to drive initiatives

- **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 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"<sup>5</sup>) 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.<sup>6</sup> 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 should 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.

<sup>5</sup> Aaron De Smet, Sarah Kleinman, and Kirsten Weerda, "The helix organization," *McKinsey Quarterly*, October 3, 2019, McKinsey.com.

<sup>6</sup> "The secrets of successful organizational redesigns: McKinsey Global Survey results," July 1, 2014, McKinsey.com.

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 to 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 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.

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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.

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# How negative emissions can help organizations meet their climate goals

Substantial negative emissions (carbon removals) are needed with emission reductions to avert catastrophic climate change. Analysis shows that negative emissions can be deployed at the required scale.

*This article was a collaborative effort by Peter Cooper, Emma Gibbs, Peter Mannion, Dickon Pinner, and Gregory Santoni, representing views from McKinsey Sustainability.*

**As governments and businesses** take up the urgent task of reducing carbon emissions, they should also consider another essential means of limiting the rise in global temperatures: removing carbon from the atmosphere through the creation of negative emissions.

As is now well known, keeping warming below 1.5°C by stemming the buildup of atmospheric CO<sub>2</sub> is critical to limiting the world’s exposure to the physical hazards resulting from climate change and to averting potentially catastrophic feedback loops in the Earth’s climate that lead to permanent warming. It’s also well established, though less well known, that keeping warming to 1.5°C will now be possible only with significant negative emissions achieved by solutions that remove carbon from the atmosphere and store it over the long term.

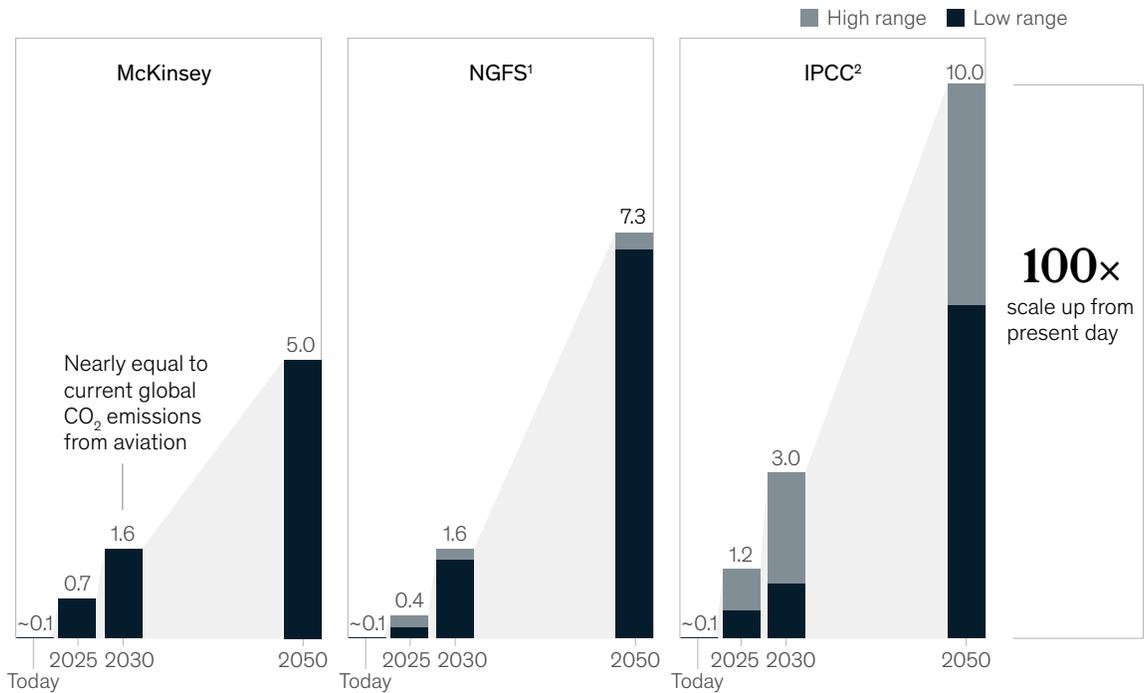
There are a wide range of negative-emissions solutions. For example, “natural climate solutions” (NCSs) such as reforestation use biological mechanisms. “Engineered removals” such as bioenergy with carbon capture and storage (BECCS) and direct air capture and storage (DACs) sequester CO<sub>2</sub> geologically—for example, in sealed rock formations underground.

Negative emissions are needed for three purposes: to offset residual, hard-to-abate emissions in industries such as cement; to lessen atmospheric CO<sub>2</sub> if emissions reductions aren’t delivered quickly enough; and to remove historical emissions from the atmosphere on a path to a stable climate over the long term. Many major scenarios for a pathway to 1.5°C, including McKinsey’s, include a substantial scale-up in negative emissions (Exhibit 1). In

Exhibit 1

## Negative emissions must scale up rapidly to meet climate targets.

### Negative emissions required in 1.5°C warming pathways, gigaton CO<sub>2</sub>



Note: For scenarios with ranges, only the high value is labeled.

<sup>1</sup>Network for Greening the Financial System.

<sup>2</sup>Intergovernmental Panel on Climate Change. Range of median values for three 1.5°C warming pathways published by the IPCC (less than 1.5°C, low overshoot, high overshoot).

Source: IPCC; NGFS; McKinsey analysis

those scenarios, negative emissions complement extensive efforts to reduce emissions rather than replacing or detracting from such efforts.

However, the world is far off from the trajectory toward sufficient negative emissions. Based on the current pipeline of negative-emissions projects, the identified need will be missed by a vast margin (Exhibit 2).

Even if all CO<sub>2</sub>-reduction targets are met, unless negative emissions are scaled, the world will likely exceed a 1.5°C carbon budget before 2040, adding more atmospheric CO<sub>2</sub> than scientists consider permissible for a 1.5°C pathway. Does that mean the world is condemned to more warming? On the contrary, a recent analysis by McKinsey for the Coalition for Negative Emissions suggests that it's possible to scale negative emissions with a portfolio of sustainable solutions. For example, NCSs and BECCS- and DACS-based solutions could deliver eight to 12 gigatons of negative emissions, even after applying stringent environmental- and economic-sustainability filters.

Our analysis shows that each of the three solutions can be sustainably scaled to more than one gigaton of production in coming decades without

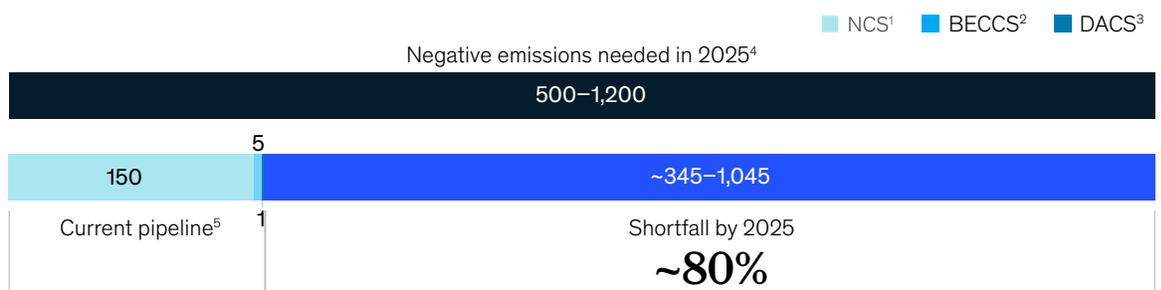
destroying existing carbon stores (such as current forest stocks), damaging sensitive ecosystems, or diverting resources from essential economic activities, such as food production. It also shows that a portfolio of at least these three solutions will be needed and that components will serve different purposes over time (Exhibit 3). Some NCSs can scale up rapidly in the near term but tend to saturate over time, while solutions involving geological storage offer lower risks of reversal (that is, release of sequestered CO<sub>2</sub>) in the longer term but may be uneconomical in the near term. These are just three possible solutions, and many others under development (for example, oceanic solutions) will need to be considered.

While NCS, BECCS, and DACS negative-emissions methods are available today, building them to the required scale will be a monumental endeavor. Achieving a 1.5°C pathway could mean constructing more than 200 gigawatt-scale BECCS power plants and thousands of DACS facilities and creating shifts in land use for NCSs of around nine times the size of the United Kingdom. Other enabling efforts, including expanding biomass supply chains, developing capital-project-delivery skills, and creating CCS networks, are also critical.

Exhibit 2

**The pipeline of negative-emissions projects is insufficient to achieve required levels of negative emissions by 2025.**

**Negative emissions required in 1.5°C warming pathways vs current pipeline, megaton CO<sub>2</sub>**

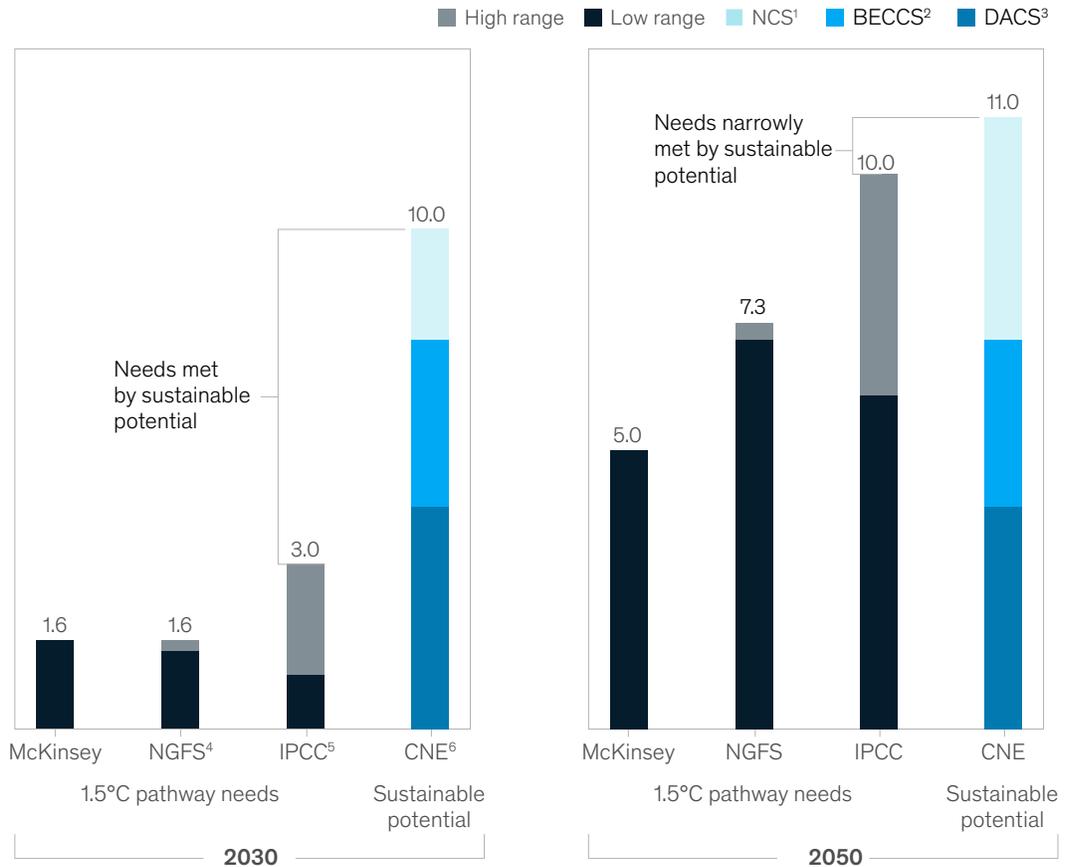


<sup>1</sup>Natural climate solutions. <sup>2</sup>Bioenergy with carbon capture and storage. <sup>3</sup>Direct air capture and storage. <sup>4</sup>Value shown represents the average of the median values for three 1.5°C warming pathways published by the Intergovernmental Panel on Climate Change (less than 1.5°C, low overshoot, high overshoot). <sup>5</sup>The estimated current pipeline of negative emissions reflects the long lead times for BECCS and DACS projects and the historic run rates for NCS projects. The BECCS pipeline estimate is based on projects recorded by the Global CCS Institute; the DACS estimate is based on the publicly stated pipelines of Carbon Engineering, Climeworks, and Global Thermostat, which are the 3 largest DACS producers; and the estimated pipeline for NCS accounts for historical activity rates (~3 mega hectares per year between 2010 and 2030 and average carbon removals of ~10 tons per hectare) and a conservative assumption of 5 full years to 2025. Source: Carbon Engineering; CCS Institute; Climeworks; FAO; IPCC; McKinsey analysis

Exhibit 3

**Together, three major negative-emissions solutions can meet the need for negative emissions in a sustainable way.**

**Negative emissions needs and potential, gigaton CO<sub>2</sub> per year**



Note: For scenarios with ranges, only the high value is labeled.  
<sup>1</sup>Natural climate solutions. <sup>2</sup>Bioenergy with carbon capture and storage. <sup>3</sup>Direct air capture and storage. <sup>4</sup>Network for Greening the Financial System. <sup>5</sup>Intergovernmental Panel on Climate Change. Range shown here represents the median values of 3 IPCC 1.5°C pathways (less than 1.5°C, low overshoot, high overshoot). <sup>6</sup>Coalition for Negative Emissions.  
 Source: CNE; IPCC; NGFS; McKinsey analysis

Our research shows that the costs of such build-outs are likely to be significantly lower than the present costs imply. Experience suggests that the costs of BECCS and DACS should reduce significantly as they become deployed more widely because of economies of scale and because additional know-how will make deployment more efficient. Once negative emissions are deployed at gigaton scale, the average cost of carbon removal could be around \$40 to \$140 per ton of CO<sub>2</sub> in 2050. In that case, a negative-emissions portfolio sufficient for a 1.5°C pathway would be \$4.2 trillion

to \$8.4 trillion cheaper to deploy than it would be at present costs.

Negative emissions offer significant opportunities for businesses that purchase them, as well as those that participate in creating carbon-removal industries. On the purchasing side, some companies have set themselves the goal of becoming not just carbon neutral but carbon negative in the coming years. Microsoft, for example, is committed to purchasing a portfolio of negative emissions as part of its effort to become carbon negative by 2030

and to remove by 2050 all the carbon it has emitted, directly or from electricity consumption, since the company's founding in 1975.

The companies that are the first to use negative emissions can realize environmental ambitions that can't be achieved through emissions reductions alone, which could enhance their standing with customers, investors, and other stakeholders. Purchasing negative emissions also allows companies to neutralize complex supply-chain or in-use (Scope 3) emissions until they can reduce such emissions and to neutralize challenging-to-abate operational (Scope 1 and 2) emissions, such as certain fertilizer emissions in agriculture and fuel emissions in aviation. These residual emissions are either extremely expensive to abate or lack any feasible technical solution today.

The companies that help build the negative-emissions industry can also help produce wider societal impacts, such as job creation and biodiversity protection. Our analysis suggests that the scale-up of negative-emissions technologies could create between four million and ten million jobs by 2050. Engineered carbon removal requires high-skill, permanent operational roles, not just temporary construction or tree-planting jobs. Importantly, industrial-scale BECCS- and DACS-based solutions could offer opportunities to redeploy experienced professionals from economically productive occupations in oil and gas production. Our research shows that 70 to 90 percent of the skill base of science, technology, engineering, and mathematics professionals in the oil and gas industries is directly relevant to such professionals in engineered carbon removal.

The environmental cobenefits of negative emissions relate to issues of global and local significance, such as biodiversity, water supply, and soil quality. Those issues, in turn, have economic implications. For example, 100 meters of restored mangroves can reduce the height of a storm surge by 20 percent, strengthening local flood defenses. Similarly, avoiding deforestation or promoting reforestation can generate negative emissions, as well as support local economies. Between 40 and 70 percent of the rainfall needed for agriculture originates from forest and vegetation evapotranspiration, so improving

forest health also helps farmers. And some \$300 billion a year is spent on tourism in protected areas; enhancing or expanding those areas through investments in negative emissions can help the local communities that derive income from tourism.

Before such benefits can be realized, there needs to be a functioning market for negative-emissions credits. Such a market doesn't exist today. Our analysis shows that in today's nascent carbon markets, supply, demand, and intermediation of negative emissions are all constrained.

On the supply side, there aren't clear standards on what constitutes a high-quality negative emission. Therefore, suppliers often self-certify, which undermines buyers' confidence and creates confusion. Also, unresolved concerns about safety and environmental impact can lead to fruitless searches for perfect solutions rather than efforts to define the shortcomings of each solution and to determine how multiple solutions might work together in a well-rounded portfolio. In intermediation, not enough infrastructure or other services are available to help turn negative emissions into investable assets, so suppliers can't easily access finance, and buyers can't make informed choices. On the demand side, companies and governments are unsure whether negative emissions hold benefits for them and what role they can play in supporting negative emissions. More generally, these institutions are deterred by the complexity of carbon markets.

Addressing those issues is likely to require coordinated effort among suppliers, buyers, oversight bodies, market makers, and the other entities involved in creating, trading, and using negative emissions. Informed by the ongoing work of the Taskforce on Scaling Voluntary Carbon Markets (for which McKinsey is providing knowledge and advisory support), the Coalition for Negative Emissions' report outlines five actions that would help establish a healthy market for negative emissions:

- defining high-quality negative emissions
- shaping a robust, liquid, and transparent market for trading negative-emission credits and generating supply-side financing

- ensuring sufficient national commitments to negative emissions (an additional effort to emissions reductions), delivered by effective government orchestration and intervention to deliver them
- agreeing on a method for transparently tracking and celebrating corporate claims, supported by clear accounting principles and a narrative that highlights the distinct value proposition of negative emissions in addition to emissions reductions
- enabling multilateral collaboration, accounting, and trade in ways that help solve the negative-emissions challenge globally

As those moves take shape, business leaders would do well to consider how to make negative emissions part of their net-zero strategies. For companies that

will purchase negative emissions, the first steps will be to understand the role that negative emissions will play in reaching net-zero targets and to engage with the market to provide a signal of future demand. The scaling up of negative emissions will create opportunities for the potential suppliers of negative emissions from solutions that include (but are not limited to) NCSs and BECCS- and DACS-based solutions. It will also create opportunities for the intermediaries that will finance the capital and operational expenditures needed to keep warming below 1.5°C.

Addressing the current shortfall in negative emissions is vital to averting extreme and irreversible global warming. As it becomes clear just how urgent the need for action is, negative emissions could become a priority, along with rapid emissions reductions, on the global climate agenda.

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# Why investing in nature is key to climate mitigation

A new consultation paper from McKinsey and the World Economic Forum explores the role that natural climate solutions can play in helping to address climate change and the destruction of nature.

*This article was a collaborative effort by Daniel Aminetzah, Emily Birch, Julien Claes, Joshua Katz, Peter Mannion, Sebastien Marlier, Dickon Pinner, and Antoine Stevens, representing views from McKinsey's Sustainability and Agriculture Practices, and McKinsey Nature Analytics.*

**As the world looks beyond** the COVID-19 pandemic, a consensus is emerging: certain measures to curb the growth of greenhouse-gas emissions will be central to global economic recovery. Awareness is also growing around the urgent need to slow the destruction of the natural world, and it is becoming clear that the two environmental crises—a changing climate and nature loss—are inextricably linked and compounding.

Natural climate solutions (NCS)—conservation, restoration, and land-management actions that increase carbon storage and avoid greenhouse-gas emissions—offer a way to address both crises and to increase resilience as the climate changes. In fact, as argued in a new paper produced by McKinsey in partnership with the World Economic Forum, there is no clear path to deliver climate mitigation without investing in nature. Climate action requires both the reduction of emissions and the removal of carbon dioxide already in the atmosphere. NCS can help with both, starting today.

Private-sector commitment to climate action is gaining momentum, with companies increasingly adopting strategies aimed at reaching net-zero emissions and some pledging to invest in nature through the purchase of NCS-generated carbon credits (or “offsets”) as part of the effort. Based on current net-zero commitments from more than 700 of the world’s largest companies, there have already been commitments of carbon credits of around 0.2 gigatons (Gt) of CO<sub>2</sub> by 2030. Some companies are even beginning to make commitments beyond carbon to biodiversity and water, which will be a growing trend over the next decade. As a core component of corporate climate mitigation, NCS are thus becoming mainstream, if not yet commonplace. While undersized overall, NCS now account for around 40 percent of retired carbon credits in voluntary carbon markets, up from only 5 percent in 2010. Leaders are also beginning to invest directly in nature through protecting and restoring large expanses of land and ocean.

The prize is large. Science tells us that if we are to establish an emissions pathway that limits warming

to 1.5 degrees Celsius above preindustrial levels, then we would need to reduce emissions by 50 percent, or 23 GtCO<sub>2</sub>, by 2030 from 2019 levels. Our analysis (see sidebar, “Methodology”) suggests that NCS projects could yield nearly a third of that target, or close to seven GtCO<sub>2</sub> per year by the end of this decade—mainly from avoided deforestation and peatland impact, reforestation, and soil sequestration in agriculture. It also shows that NCS, and in particular forestry projects, are largely a low-cost measure. In addition, there are substantial co-benefits of NCS, both from promoting environmental benefits such as biodiversity and water quality, and from fostering capital flows to forest-rich countries in the Global South in support of sustainable development. With close to seven GtCO<sub>2</sub> in annual potential by 2030, assuming an illustrative price per ton of \$20<sup>1</sup> would suggest potential capital flows greater than \$100 billion to countries in the Global South that have high concentrations of NCS potential.

Yet the ambition to undertake NCS at global and meaningful scale is bedeviled by a number of difficulties, both real and perceived. These difficulties include the lack of consensus on how to treat NCS in corporate claims on climate action, combined with low public confidence in the effectiveness of past NCS schemes in contributing to real emissions reduction. There is a widespread suspicion that companies may be tempted to use NCS offsetting as an excuse to avoid fully addressing their own carbon footprint, despite clear guidance that direct emissions avoidance and reduction by corporations must be the priority.<sup>2</sup>

Other inhibitors to investment include the absence of an agreed-upon method to measure and recognize co-benefits of NCS for biodiversity, soil and water quality, and community livelihoods—for example, in resource-rich forest countries; undeveloped market infrastructure; and pervasive uncertainty about future supply and demand. There are challenges to ensuring that NCS projects produce carbon reductions that are genuinely additional (that is, reductions that would not have happened otherwise) and permanent. In the past, this overall lack of

<sup>1</sup> A price per ton of \$20 reflects the weighted average of cost per ton for the NCS analyzed in detail for this report.

<sup>2</sup> See Taskforce on Scaling Voluntary Carbon Markets, [iif.com/tsvcm](https://www.iif.com/tsvcm).

confidence has manifested itself in low price levels and oversupply of carbon credits in general, and of forestry credits in particular.

Building on other recent work aimed at developing the voluntary carbon market, in particular that of the Taskforce on Scaling Voluntary Carbon Markets (TSVCM), the paper proposes six steps to address these deficiencies:

1. **Define net-zero and corporate claims:** Agreement is needed on NCS standards and certification under one commonly accepted international-standards body. This would provide a more solid foundation for companies to make and validate claims concerning targets for carbon reduction and compensation, and to show precisely how they intend to attain net-zero emissions.
2. **Highlight good practice for supply:** To address public concerns about the validity of NCS in achieving real and permanent carbon reductions, practitioners need to publicize recent progress in establishing good practices—for example, more rigorous measurement and verification methods and advances in sustainable land-use policies.
3. **Send a demand signal:** Carbon emitters should agree to prioritize high-quality NCS credits with large co-benefits: this would send a powerful demand signal to build confidence and solidify pricing across carbon markets, and it would encourage policy makers and credit originators to increase the project pipeline.
4. **Improve market architecture:** Standards, infrastructure, and financing need to be developed to support the growth of NCS-producing tradable credits, as set out in the recent TSVCM report. Necessary steps include the creation of carbon reference contracts that allow prices to reflect co-benefits of NCS, a radical improvement in the availability of quality market data, and the development of centralized carbon exchanges.
5. **Create regulatory clarity:** Policy makers must focus on turning national and corporate carbon-reduction targets into actionable plans

## Methodology

The estimate produced by McKinsey Nature Analytics—that “practical” potential of NCS projects is 6.7 gigatons (Gt) of CO<sub>2</sub> per year by 2030, or about one-third of the total required emissions reduction—is conservative compared with existing literature on the topic. The estimate is arrived at through granular geospatial analysis to find total abatement potential (10.2 GtCO<sub>2</sub> per year by 2030) and the application of an economic feasibility filter that removes high-cost land area (agricultural returns of more than \$45 per hectare per year).

underpinned by binding regulation. Clarity is also needed about how NCS projects can be accounted for within national carbon-reduction goals, how to integrate voluntary and compliance carbon markets, and how to organize the international transfer of carbon credits.

6. **Build trust:** There is a need for greater collaboration among stakeholders in order to address the perceived credibility issues of NCS. A coalition of high-level champions can help amplify the call for high-quality, high-ambition NCS.

For the private sector, NCS offers vast opportunities, and momentum behind realizing them is growing. For example, Amazon is spending \$10 million to restore 1.6 million hectares of forest in the United States; Nestlé is investing in ending deforestation and in forest restoration in Ghana and Côte d'Ivoire; and Shell is planting five million trees in the Netherlands, among other climate commitments. Walmart has pledged to be net zero in operations by 2040 and to manage or restore 50 million acres of land and one million square miles of ocean. Within their net-zero commitments, companies such as Unilever and PepsiCo have committed specifically to NCS, recognizing the importance of engaging across the

value chain with farmers and growers, who are critical to protecting and restoring landscapes and forests.

Another area of opportunity lies in enabling technologies that help unlock NCS potential: for example, hardware can physically enable NCS, such as enhanced tree-planting technologies and software that can improve the effectiveness and the monitoring of NCS.

What is beyond doubt is that NCS is a key component both of the effort to reduce and sequester carbon emissions, and of the necessary campaign to combat nature loss. International focus on these twin crises is growing, and governments and companies are making bolder commitments. It is time to scale up NCS within a market framework and turn these commitments into action.

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# Transform in the cloud

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for grabs





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# Three actions CEOs can take to get value from cloud computing

Leaders need to accelerate their journey to the cloud in order to digitize quickly and effectively in the wake of COVID-19.

*This article was a collaborative effort by Chhavi Arora, Tanguy Catlin, Will Forrest, James Kaplan, and Lars Vinter.*

**If you are a CEO**, you already know what the cloud<sup>1</sup> can do for your business in a post-COVID-19 world. You've probably even told your organization to get you there already. So why is your move to the cloud coming along so slowly, even though you may have been talking about it for years? It might be because you and your management team have yet to take a sufficiently active role or to provide the air cover your chief information officer (CIO) and chief technology officer (CTO) need.

CIOs and CTOs are on the front foot right now thanks to their crucial role during the COVID-19 pandemic. That makes this a good moment to further elevate top-team support for the cloud enablement needed to accelerate digital strategy, as well as the digitization of the company, its channels of distribution, and its supply chains—all of which already needed to be moving more quickly.

The CEO's role is crucial because no one else can broker across the multiple parties involved, who include the CIO, CTO, CFO, chief human-resources officer (CHRO), chief information security officer (CISO), and business-unit leads. As we explain in this article, the transition to cloud computing represents a *collective-action problem*—one that requires a coordinated effort across the team at the top of an organization. It's a matter of *orchestration*, in other words, and only CEOs can wield the baton.

To get to cloud more quickly, CEOs should ask their CIO and CTO what support they need to lead the organization on the journey. Chances are good that three interventions will emerge:

1. establishing a sustainable funding model to support the investments required to get business value from the cloud
2. developing a new business-technology operating model<sup>2</sup> that exploits cloud for speed, agility, and efficient scalability

3. putting in place the HR, compensation, and location policies required to attract and retain the specialized engineering talent needed to operate in the cloud

Together, these interventions will help the executive team unite around a coherent point of view about the business-driven value that the cloud represents, how to capture that value, and how to evolve the company's operating model accordingly. Without this perspective, your company may continue to move too slowly toward cloud computing<sup>3</sup> for a post-COVID-19 "next normal"—creating the risk of disruption from nimbler attackers.

### **Invest for business value**

During the past 20 years, IT organizations have adopted a range of innovations—for example, virtualization and Linux—that have made running business applications much cheaper and that have required only modest investments. Cloud adoption has a different economic profile. While exploiting cloud requires investment in building capabilities and migration applications, it's more efficient in the long term, sometimes markedly so for companies that have not fully optimized their technology environment.

The biggest benefits accrue to the business from faster time to market, simplified innovation, easier scalability, and reduced risk. Cloud platforms can help deploy new digital customer experiences in days rather than months and can support analytics that would be uneconomical or simply impossible with traditional technology platforms.

Unfortunately, technology-funding mechanisms can stymie cloud adoption—they prioritize features requested by the business now rather than critical infrastructure investments that will allow companies to add functionality more quickly and easily in the future. Each new bit of tactical business functionality built without best-practice cloud architectures adds to your technical debt<sup>4</sup>—and

<sup>1</sup> In this article, we use "cloud" to refer to the public cloud rather than companies' private clouds, in which they attempt to create highly automated and virtualized application-hosting environments on premises.

<sup>2</sup> An integrated operating model organizes technology teams around user-facing products and the underlying platforms that enable them. For more, see Ross Frazier, Naufal Khan, Gautam Lunawat, and Amit Rahul, "Products and platforms: Is your technology operating model ready?," February 28, 2020, McKinsey.com.

<sup>3</sup> Nagendra Bommadevara, James Kaplan, and Irina Starikova, "Leaders and laggards in enterprise cloud infrastructure adoption," October 19, 2016, McKinsey.com.

<sup>4</sup> Technical debt is the implied cost of rework caused by implementing a quick but brittle or otherwise architecturally suboptimal solution.

thus to the complexity of building and implementing anything in the future.

CEOs can help the senior team recognize that infrastructure investments in cloud platforms represent a source of competitive advantage rather than a cost to be managed. Once the top team gets that right, a lot of other things fall into place, including your technology-funding process, which begins shifting toward *products* or *platforms* rather than *projects*. Projects are one-time investments funded in a yearly boom-and-bust cycle. Products in general (and cloud platforms in particular) require more stable, ongoing funding and consistent “ownership” to optimize new functionality and mitigate technical debt.

The top-team conversation will benefit, too, from a prioritized, sometimes multiyear road map of domains in which the cloud will accelerate performance and digital transformation. This will help prioritize investments—and avoid defaulting to applications that are technically easiest to migrate. By asking which business domains (such as order capture, billing, or supply-chain optimization) would benefit most from the speed, innovation, and scalability that cloud platforms can provide, top teams can arrive at the highest-priority areas for movement to the cloud.

Inevitably, resource-allocation issues will arise. Growth businesses, for example, may be most likely to benefit from the cloud, but they are the least likely to have high margins or excess cash to pony up for a cloud investment. More mature business units may have higher margins, but where, exactly, should they get the money needed for the cloud—by spending less on tactical functionality this year and next, or by reducing marketing expenditure? Does a legacy business have the legs to support a long-lived cloud investment? Should the CEO transfer money from one business unit to another, or accept lower margins when a business invests in the cloud? Such questions are unlikely to be asked, much less answered, without serious engagement from the CEO and other members of the top team.

A big financial-information provider, for example, determined that moving applications in its customer-

facing business domains to the public cloud could enable much faster and less expensive entry into promising markets. Hosting these applications in the cloud meant that technology operations in a new country could be set up in a couple of weeks at a negligible cost, versus a couple of million dollars of up-front investment for each country. A health-insurance carrier, meanwhile, examined its current project portfolio and found that it could speed up the capture of several billion dollars in additional revenue by adopting the cloud. Moving the systems that help the insurer interact with healthcare providers was especially attractive because of the opportunity to accelerate the onboarding of new providers.

Then, once the investment is made, it's up to the CEO to demand higher business performance in return for the cloud investment—no more deflecting blame for subpar outcomes to a subpar technology environment. If the strategic case for the cloud is real, it should translate into better performance. The CEO must demand that it does.

## **A new operating model**

Once the funding model is straightened out, companies must ground the new partnership between IT and the businesses in an operating model that reflects and supports their growing investment in the cloud.

Here, it will help to think about an integrated system rather than a set of individual technologies. Doing so implies organizational change across all of IT, and many of the business units and functions as well. This operating model combines cloud-based digital technologies and agile operational capabilities in an integrated, well-sequenced approach that can rapidly accelerate digital strategy and transformation. The model helps to coordinate end-to-end operations across silos—supporting customer and employee journeys, for instance—while taking technology out of quarantine and making the most of it across all lines of business.

A cloud-ready business-technology operating model has many requirements. Here, we focus on the few that need intervention from the CEO.

### **Improving business interaction**

Achieving the speed and agility that cloud platforms promise requires frequent interaction—for instance, to define and optimize customer journeys—between IT managers and their counterparts in business units and functions, particularly those who own products and capability areas. CEOs need to encourage business leaders to appoint knowledgeable decision makers as product owners for each business capability.

Too often, business units appoint product owners who are too new or too junior and who lack either the knowledge or the organizational throw weight to make their decisions stick. Many of these product or capability owners are “process jockeys” whose expertise is coordinating stakeholders and tasks. Look instead for more senior folks capable of thinking broadly and strategically.

### **Going agile in IT**

If your company is to gain value from the cloud, your IT department must become agile, if it isn't already. That involves more than moving development teams to agile product models. Agile IT also means bringing agility to your IT infrastructure and operations by transforming infrastructure and security teams from reactive, “ticket driven” operations into proactive models in which scrum teams develop the application program interfaces (APIs) that service businesses and developers can consume.

Counterintuitively, you should avoid inserting translators between IT and the businesses. Instead, look to organizational groupings that unite business, technology, governance, process, and people management. These quickly moving *modular platforms* should be run by a platform owner who takes end-to-end responsibility for providing a solution and operating the platform as a service.

### **Accounting for the risks**

Everything in enterprise technology implies risk. To mitigate security, resiliency, and compliance concerns relating to the adoption of the cloud, companies must be clear-eyed about these risks. Among other things, that means holding rigorous discussions about the best mechanisms for aligning the appetite for risk with decisions about the technology environment. Getting the organization

to take the right tone on risk will require particular attention from the CEO. It's easy to let worries about security, resiliency, and compliance stop a cloud program in its tracks. Instead of letting risks derail progress, CEOs should insist on a pragmatic risk appetite that reflects the business strategy, while placing the risks of cloud computing in the context of the existing risks of on-premises computing and demanding options for mitigating risks in the cloud.

Companies that get the operating model right can see dramatic improvements. These include better target-state economics and lower transition costs. They will also see improved agility and ability to innovate. One natural-resource company implemented agile ways of working for business-application development, infrastructure, and security. In particular, it invested in creating automated, API-based services that developers could use to provision workloads on cloud platforms securely and resiliently. As a result, the company started releasing new capabilities in days rather than months, while limiting risk and technical debt.

### **Revisit talent**

As your cloud investment picks up speed, supported by a new, cloud-ready operating model, your CIO will no doubt be asking for the talent needed for cloud. Although cloud computing can dramatically boost the productivity of technology, it requires specialized and sometimes hard-to-find technical talent—full-stack developers, data engineers, cloud-security engineers, identity- and access-management specialists, and cloud engineers. Such talent can be hired externally or upskilled from within. Just make sure current HR policies and approaches don't hobble your approach. The basis of performance management and promotion, for example, should be expertise rather than the number of direct reports someone oversees.

If your HR policies are not up to speed, you may need to provide some air cover for your CIO with the CHRO. Some policies, put in place a decade ago to contain IT costs, can get in the way of onboarding cloud talent. Over the years, companies have adopted policies that limit costs per head and the number of senior hires, for example, and

that require the use of outsourced resources in low-cost locations. Collectively, these policies produce the reverse of what the cloud requires, which are relatively small numbers of highly talented and expensive people who may not want to live in traditional low-cost IT locations. The location issue is why CEOs who are serious about the cloud have suggested that their CHROs reverse policies encouraging the use of low-cost, commoditized tech talent. In some cases, this new direction takes the form of newly established tech centers in places such as the US West Coast, which are specifically designed to attract cloud talent.

CEOs must also make sure their technology leaders get sufficient voice in senior forums and management processes, given the increasingly fast integration of digital and business strategy. At many companies, CIOs and CTOs have been among the heroes of the COVID-19 response by pivoting their organizations to enable pervasive remote working, often in a matter of days. The cloud allows CIOs and CTOs to play an even more critical role in making business strategies successful.

Compared with traditional IT managers, successful CIOs and CTOs in this environment will be both more plugged into a company's digital transformation and more technologically savvy. In a post-COVID-19 next normal, these executives cannot rely on vendors to figure everything out for them. They must be open to new ideas and willing to learn, to take risks,

and to fail fast—and then quickly correct course when necessary. It helps if they're compelling communicators who can inspire both business partners and their own teams to undertake dramatic change.

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The COVID-19 pandemic has heightened the need for companies to adopt digital business models—and only cloud platforms can provide the agility, scalability, and innovation required for this transition. Although there have been frustrations and false starts in the enterprise journey to the cloud, companies can dramatically accelerate their progress by investing in areas that will provide the most business value and by building cloud-ready operating models.

But they have to get there first. And that's where CEOs have an important role to play—first by becoming more technologically savvy than they have been in the past, and next by addressing the collective-action problem that often prevents companies from embracing new strategic roles for IT. If companies are to be successful in a digital next normal, their CEOs must ensure that their management teams understand the specific ways that cloud computing can raise revenue growth and margins and how, in close alignment, those teams will rally to capture value.

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# Cloud's trillion-dollar prize is up for grabs

Cloud has immense potential, but most companies are only scratching the surface. Recent research clarifies where the value lies—and how to capture it before competitors do.

*This article was a collaborative effort by Will Forrest, Mark Gu, James Kaplan, Michael Liebow, Raghav Sharma, Kate Smaje, and Steve Van Kuiken, representing views from McKinsey Digital.*

**Moderna CEO Stéphane Bancel** made the decision to build his mRNA research-and-development platform on public cloud to create what he calls “software for life.”<sup>1</sup> He used the cloud as a means to accelerate therapeutic discovery and development. When the COVID-19 pandemic hit, this strategy proved prescient. The company was well positioned to quickly design research experiments and to harness its automated laboratory and manufacturing processes and enhanced drug-discovery pipeline.

Moderna runs its Drug Design Studio, a proprietary web application, on cloud and leverages cloud’s scalable compute and storage infrastructure to analyze and quickly design mRNA sequences for protein targets. Scientists and engineers also use fully managed cloud data-warehousing services to integrate insights from multiple experiments running in parallel and quickly refine the design and production cycle.<sup>2</sup> Moreover, the adoption of cloud principles, such as infrastructure as code (IaC) and security as code, helped to automate good-practice (GxP) compliance processes so the organization can move quickly while staying secure and compliant.<sup>3</sup> Thanks in part to cloud, Moderna was able to deliver the first clinical batch of its vaccine candidate (mRNA-1273) to the US National Institutes of Health for phase one trials just 42 days after the initial sequencing of the virus,<sup>4</sup> “because you don’t have to reinvent everything, you just fly,” Bancel said.<sup>5</sup>

More companies are starting to see the real benefits of cloud,<sup>6</sup> which has been long heralded as a catalyst for innovation and digital transformation thanks to its ability to increase development speed and provide near-limitless scale. While Moderna’s success illustrates the business opportunities that cloud makes possible, it only scratches the surface of the potential value at stake. A detailed review of cloud cost-optimization levers and value-oriented business use cases foresees more than \$1 trillion in run-rate earnings before interest, taxes, depreciation, and amortization (EBITDA) across

Fortune 500 companies as up for grabs in 2030 (see sidebar, “About the research”), a number that will grow as cloud facilitates the adoption of emergent technologies such as augmented reality and blockchain. This \$1 trillion is less a prediction than an estimate of what should be possible, provided companies aggressively pursue the cloud opportunity—and a call to action, because early adopters will capture a disproportionate share of the total value.

The emergence of this immense value pool comes at a time of increasing competitive pressure on companies. Fast-moving digital players are creating a fluid business landscape and accelerating the pace of change. For CEOs, cloud adoption is not just an engine for revenue growth and efficiency. Its speed, scale, innovation, and productivity benefits are essential to the pursuit of broader digital business opportunities, now and well into the future. Yet an overly narrow view of cloud-value economics and where value exists often keeps companies from achieving the desired outcomes.

The good news is that many companies across a range of industries have successfully implemented public cloud to achieve impressive results. These companies follow three best practices. First, they execute a well-defined, value-oriented strategy across IT and businesses and install a cloud-ready operating model. Second, they develop firsthand experience with cloud and adopt a much more technology-forward mindset than their peers. And finally, they excel at developing a cloud-literate workforce.

Our research identifies the pools of value for cloud adoption across three dimensions—rejuvenate, innovate, and pioneer—as well as the drivers of that value across the first two dimensions. It also highlights likely avenues for growth in the pioneer dimension. CEOs can begin their journey by working with their tech leadership to focus on four actions: set ambitious targets, pursue a hard-headed economic

<sup>1</sup> Tyler Clifford, “How Moderna is using Amazon cloud to produce personalized cancer vaccines,” CNBC, January 15, 2020, [cnbc.com](https://www.cnbc.com).

<sup>2</sup> “AWS powers Moderna’s digital biotechnology platform to develop new class of vaccines and therapeutics,” *Business Wire*, August 5, 2020, [businesswire.com](https://www.businesswire.com).

<sup>3</sup> *AWS for Industries*, “Automating GxP compliance in the cloud: Best practices and architecture guidelines,” blog entry by Susant Mallick and Chris McCurdy, November 19, 2019, [aws.amazon.com/blogs](https://aws.amazon.com/blogs).

<sup>4</sup> “Moderna announces positive interim phase 1 data for its mRNA vaccine (mRNA-1273) against novel coronavirus,” Moderna, May 18, 2020, [investors.modernatx.com](https://investors.modernatx.com).

<sup>5</sup> Clifford, “How Moderna is using Amazon cloud.”

<sup>6</sup> Throughout this article, “cloud” refers to the public cloud.

case, adopt cloud-native ways of working, and invest in standardized, automated cloud platforms.

### Dimensions of value

We have sized the value for the rejuvenate and innovate dimensions only, since many of the use cases in the pioneer dimension are still evolving, and their 2030 impact is difficult to quantify with any precision. They do, however, present the next stage of value evolution in cloud, so leaders should start experimenting in earnest now to harness these technologies in the near future.

Companies in every industry can capture substantial value from cloud, but it isn't distributed evenly. High tech, oil and gas, retail, healthcare systems and

services, insurance, and banking are positioned to generate the most value as measured by EBITDA impact in 2030, although almost all industries across the Fortune 500 show potential for an average rise in EBITDA of more than 20 percent (Exhibit 1).

This value distribution is likely to change as the impact of cloud evolves. Democratized access to computational power and infrastructure could reshape the landscape in industries that have historically not been highly competitive. Like several previous technology disruptions, cloud shifts barriers to entry in many markets from scale to skill, enabling smaller companies with the right skills to scale businesses on the latest infrastructure without worrying about up-front costs—thus creating a threat to slower-moving incumbents.

## The value of cloud transcends IT and is estimated at more than \$1 trillion.

### 1. Rejuvenate \$430 billion

#### IT cost optimization

Cost optimization of application development and maintenance and IT infrastructure

#### Risk reduction

Improved business resilience of the organization

#### Core-operations digitization

Implementation of latest technological/digitization achievements in core operations

### 2. Innovate \$770 billion

#### Innovation-driven growth

Business growth from new and enhanced use cases in analytics, IoT, and automation

#### Accelerated product development

Enhancement of operating-model agility, ease of cloud configuration, and democratized access to computational power

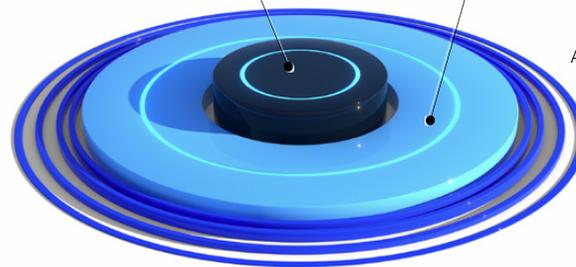
#### Hyper-scalability

Access to instant on-demand elasticity in compute and storage capacity to scale across customer segments, geographies, and channels

### 3. Pioneer Additional opportunity

#### Early adoption of cloud technology

Embracing culture of experimentation with low cost of failure and gaining experience in cloud technology, which is an enabler for early adoption of future tech such as quantum computing, AR/VR/MR (mixed reality), blockchain, and 3-D/4-D printing



Source: Independent third-party research data (OmnicomGroup and Known), industry and McKinsey expert interviews, McKinsey D2020 IT cost benchmarking, McKinsey Global Institute research

Exhibit 1

**Capture of cloud's economic value is expected to differ by industry.**

**Impact of cloud use cases and improvements**  
 Estimated 2030 EBITDA<sup>1</sup> run-rate impact

■ 1. Rejuvenate ■ 2. Innovate

|                                       | # of companies | EBITDA impact, \$ billion | EBITDA impact as % of 2030 EBITDA |
|---------------------------------------|----------------|---------------------------|-----------------------------------|
| High tech                             | 30             | 110–160                   | 28–40                             |
| Oil & gas                             | 45             | 80–160                    | 29–60                             |
| Retail                                | 64             | 90–140                    | 31–53                             |
| Healthcare systems & services         | 30             | 70–140                    | 35–74                             |
| Insurance                             | 45             | 70–110                    | 43–70                             |
| Banking                               | 36             | 60–80                     | 13–17                             |
| Automotive & assembly                 | 23             | 40–60                     | 31–54                             |
| Telecom                               | 12             | 40–60                     | 12–19                             |
| Advanced electronics & semiconductors | 25             | 30–50                     | 12–25                             |
| Consumer packaged goods               | 43             | 20–40                     | 11–20                             |
| Transport & logistics                 | 20             | 20–40                     | 24–41                             |
| Pharmaceuticals & medical products    | 12             | 20–40                     | 9–19                              |
| Media & entertainment                 | 14             | 20–30                     | 12–18                             |
| Travel                                | 11             | 10–30                     | 28–44                             |
| Aerospace & defense                   | 12             | 10–20                     | 14–22                             |
| Basic materials                       | 23             | ~10                       | 11–20                             |
| Chemicals                             | 15             | ~10                       | 10–18                             |
| Electric power & natural gas          | 14             | ~0                        | 5–7                               |
| Infrastructure                        | 13             | ~0                        | 12–21                             |
| <b>Total</b>                          | <b>487</b>     | <b>700–1,200</b>          | <b>20–34</b>                      |

<sup>1</sup>Earnings before interest, taxes, depreciation, and amortization.  
 Source: Independent third-party research data (Omnicom Group and Known), industry and McKinsey expert interviews, McKinsey D2020 IT cost benchmarking, McKinsey Global Institute research

Use cases also differ by industry. Solutions that unlock the value of cloud include inventory optimization in retail, automated forecasting in oil and gas, chatbot support for high tech, and customer-call-center optimization in banking (Exhibit 2).

**Capturing value: Seven value drivers underpin the three dimensions**

As companies assess the opportunities enabled by cloud, a detailed review of the sources of value can pinpoint where they need to focus their attention, people, and resources. Across the three dimensions, seven drivers of value can collectively generate more than \$1 trillion in value (Exhibit 3).

**Rejuvenate**

Rejuvenation describes a break from traditional legacy approaches by using cloud to lower costs and risk across IT and core operations.

**Value driver 1: IT cost optimization**

The traditional on-premise model for managing applications and infrastructure is inherently inefficient. It is highly manual and typically uses expensive technology equipment at less than full capacity.

The economics of cloud computing is both controversial and complicated. On the one hand, cloud provides access to automated capabilities that

Exhibit 2

## Cloud can unlock substantial value for technology use cases.

### Examples

|   |   |    |                         |    |
|--|--|--|--|---|
| Retail   | Healthcare systems & services  | High tech  | Oil & gas  | Banking   |
| <p><b>Inventory optimization:</b><br/>Large sets of data are analyzed daily to increase accuracy and maximize availability while minimizing risk of waste</p>  | <p><b>Analytics-driven procurement:</b><br/>Document analysis converts scanned documents into searchable text, and machine-learning (ML) models identify clauses of interest</p> | <p><b>Chatbots:</b> Provide first-level support and answer most FAQs via phone, email, and chat</p>  | <p><b>Parameter optimization:</b><br/>Data-driven analytics adjust well settings to increase output</p>    | <p><b>Digital advertising:</b><br/>Customized web service based on digital advertising and customer browsing behavior</p>                                   |
| <p><b>Design to value:</b><br/>Techniques such as sentiment analysis and social-media listening are used to predict which products are likely to succeed and to develop product economics</p>            | <p><b>Trial-site optimization:</b><br/>Analytics-driven tools optimize site portfolios</p>   | <p><b>Customer-retention management:</b><br/>Customer-loyalty protection through holistic programs driven by advanced analytics and dedicated execution capabilities</p> | <p><b>Automated forecasting:</b> Automated demand-and-supply modeling reduces need for manual analysts</p> | <p><b>Next-product-to-buy algorithms:</b> Enhanced recommendation engines with advanced matching techniques</p>   |
| <p><b>Omnichannel fulfillment optimization:</b><br/>Aggregation of fast-moving data coupled with AI/ML-based insights to optimize inventory across channels, offering a seamless customer experience</p> | <p><b>Remote health monitoring:</b> Used in virtual trials and for adherence improvement</p>   | <p><b>Media-channel optimization:</b><br/>Maximized ROI on media spend through multivariable modeling for optimal mix across channels</p>                                | <p><b>Condition-based maintenance:</b> Active equipment monitoring to prevent unexpected breakdowns</p>    | <p><b>Customer-call optimization:</b> Real-time voice-recognition algorithms redirect distressed customers to experienced handlers for retention offers</p> |

Source: Google Cloud and McKinsey Global Institute research

enterprises could never afford to develop on-premise, and cloud service providers (CSPs) leverage inverse-correlation-of-workload-usage patterns to run their assets at much higher utilization. On the other hand, CSPs charge based on consumption, and companies must remediate existing applications for them to run efficiently in the cloud.

Similarly, “lift and shift” migrations of existing on-premise applications to cloud can actually

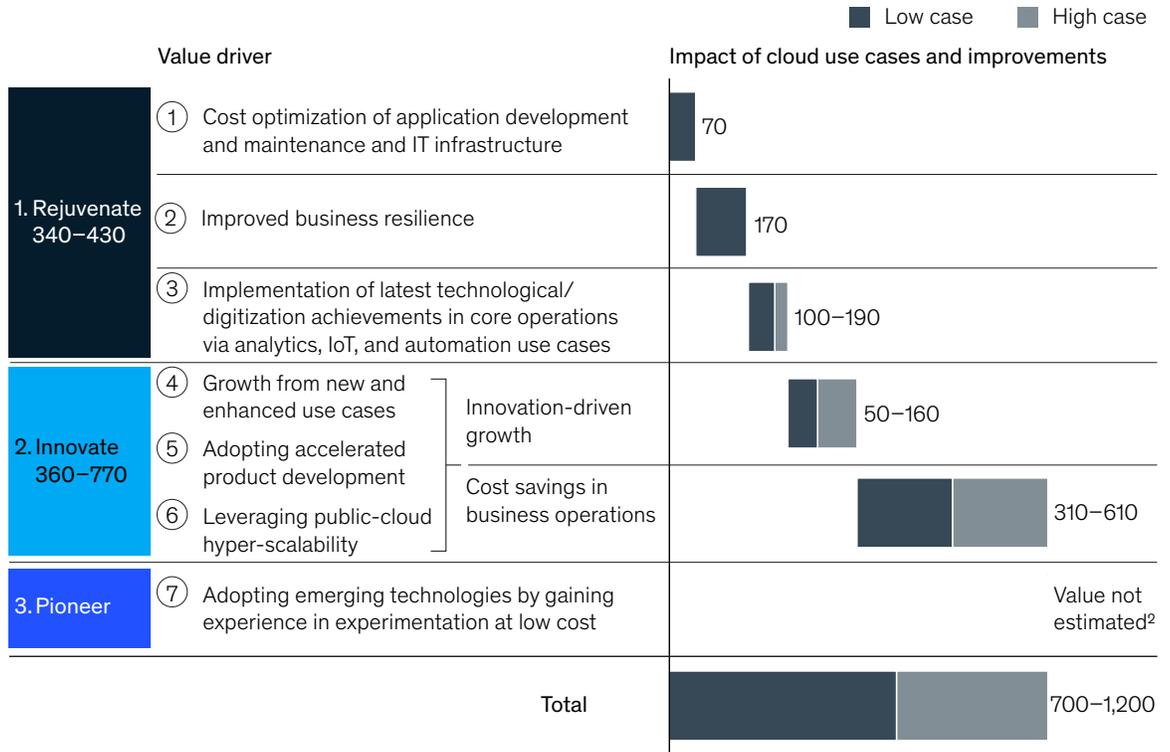
increase cost if they are not optimized or remediated correctly. In contrast, companies that have built new systems in the cloud or that have remediated existing applications to leverage cloud attributes are seeing dramatic efficiency improvements. Cloud also enables greater development productivity through new ways of working, such as agile and development, security, and operations (DevSecOps), and efficiency improvements through API<sup>1</sup>-based or self-service-based workflows and automation—

<sup>1</sup> Application programming interface.

Exhibit 3

**Seven value drivers could enable cloud to deliver more than \$1 trillion in EBITDA value across the Fortune 500 by 2030.**

**Estimated 2030 EBITDA<sup>1</sup> run-rate impact, \$ billion**



Note: Cost of implementation is not included in calculation.  
<sup>1</sup> Earnings before interest, taxes, depreciation, and amortization.  
<sup>2</sup> Premature to estimate value in 2030.  
 Source: Independent third-party research data (OmnicomGroup and Known), industry and McKinsey expert interviews, McKinsey D2020 IT cost benchmarking, McKinsey Global Institute research

for example, automated patching. Early research indicates that developers spend measurably less time on infrastructure and production support and more on business requirements and development when companies move to public cloud.

Research also indicates that effective cloud usage can improve application development and maintenance productivity by 38 percent and infrastructure cost efficiency by 29 percent for migrated applications. As a result, increasing the share of Fortune 500 applications in the cloud from 10 percent to 60 percent would yield benefits of \$56 billion in application development and maintenance and \$12 billion in infrastructure expenditures.

As it recovered after a cyberattack, Maersk, the largest container-shipping line and vessel operator in the world, used the cloud to build new capabilities at half the cost of doing it on-premise. The company implemented a new IT operating model to enable user self-service and put the responsibility for resource management in the hands of users. Recognizing the need for centralized governance, Maersk created the tools and processes to allow for real-time charge-backs at a project level, visibility into license management, and better analytics to understand consumption patterns and potential cost savings.

A Fortune 500 consumer-packaged-goods company had been relying on a mainframe with

## About the research

To quantify the total potential value that companies could generate by adopting cloud, we conducted detailed analysis based on three reports from the McKinsey Global Institute (MGI); McKinsey D2020 benchmarking for IT spending structure based on more than 1,000 IT diagnostics worldwide; and independent third-party surveys of more than 1,000 organizations that have adopted cloud to pursue potential operational efficiency gains. In applying the MGI research, we assessed more than 700 use cases across 19 industries. We used industry-level, historical, real-revenue growth rates (4 percent weighted average across industries) to forecast revenues to 2030. To forecast 2030 EBITDA and costs, we applied the 2019 EBITDA margin (17 percent) to the projected 2030 revenues. We estimated the revenues and EBITDA of Fortune 500 companies to 2030 to establish a baseline for the assessment. The analysis identified three dimensions for cloud adoption (Exhibits A and B).

For the first dimension, rejuvenate, we calculated the potential value from IT cost efficiency across application

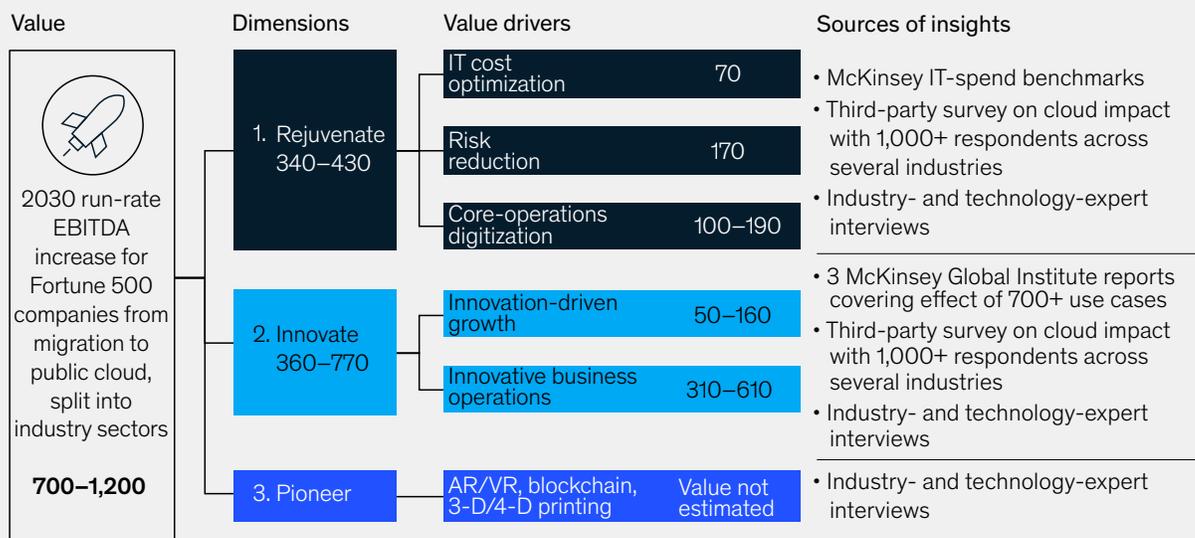
development and maintenance and infrastructure spending, drawing on double-blind surveys of more than 1,000 cloud-adopting companies conducted by Omnicom Group, an independent third-party market-research firm. The cost baseline has been assessed by drawing on McKinsey's proprietary D2020 knowledge base, which encompasses holistic IT-performance diagnostics conducted at more than 1,000 clients spanning more than 20 industries and all geographies, and IHS Markit and Oxford Economics market projections. In addition, we have analyzed reports by Ponemon Institute, IBM Security, and CyberEdge Group to estimate the value in reduced risk of breaches and lower spending on cybersecurity and breach management. Last, we assessed the potential improvement in back-office performance from cloud's ability to accelerate and unlock technology use cases.

For the second dimension, innovate, we assessed revenue uplift (the margin impact of revenue increases) and cost savings from business operations. We quantified

Exhibit A

### Value was estimated from the bottom up, based on use cases, benchmarks, surveys, and expert input.

#### Estimated additional run-rate EBITDA<sup>1</sup> of Fortune 500 companies in 2030, \$ billion



Note: Cost of implementation is not included in calculation.

<sup>1</sup>Earnings before interest, taxes, depreciation, and amortization.

Source: Independent third-party research data (OmnicomGroup and Known), industry and McKinsey expert interviews, McKinsey D2020 IT cost benchmarking, McKinsey Global Institute research

## Significant value exists in increasing public-cloud adoption from 10 to 60 percent, particularly in innovative business operations.

| Dimensions<br>Estimated additional run-rate EBITDA <sup>1</sup> of Fortune 500 companies in 2030, \$ billion |                                     | Value drivers   | Baseline<br>Run-rate financials of Fortune 500 companies in 2030, \$ billion | Impact of moving from current 10% to 60% of estate migrated to public cloud                           |   |
|--|-------------------------------------|---|--|---|---|
|  |                                     |   |  | Impact potential<br>Estimated additional run-rate EBITDA of Fortune 500 companies in 2030, \$ billion | Impact vs baseline<br>Estimated relative run-rate improvement against baseline of Fortune 500 companies in 2030 |
| 1. Rejuvenate<br>340–430   | IT cost optimization                | 765<br>IT costs (software ADM <sup>2</sup> and infrastructure, including incident management) | 70<br>Cost-reduction potential   | 9%<br>Cost-reduction potential  |   |
|  | Risk reduction                      | 659<br>Cost of downtime and cybersecurity   | 170<br>Cost-reduction potential  | 26%<br>Cost-reduction potential   |   |
|  | Core-operations digitization        | 6,543 <sup>3</sup><br>Core-operations costs   | 100–190<br>Cost-reduction potential  | 2–3%<br>Cost-reduction potential  |   |
| 2. Innovate<br>360–770   | Innovation-driven growth            | 20,166<br>Revenue   | 50–160<br>EBITDA improvement potential                                       | 0.2–0.8 pp <sup>4</sup><br>EBITDA margin improvement potential  |   |
|  | Innovative business operations      | 8,736 <sup>3</sup><br>Business-operations costs   | 310–610<br>Cost-reduction potential  | 4–7%<br>Cost-reduction potential  |   |
| 3. Pioneer   | AR/VR, blockchain, 3-D/4-D printing | ← Value not estimated →   |  |   |   |
| EBITDA   |                                     | 3,476<br>EBITDA   | 700–1,200<br>EBITDA improvement potential                                    | 20–34%<br>EBITDA improvement potential  |   |

Note: Cost of implementation is not included in calculation.

<sup>1</sup>Earnings before interest, taxes, depreciation, and amortization.

<sup>2</sup>Application development and maintenance.

<sup>3</sup>Calculated as revenue minus EBITDA minus IT costs minus risk-related costs, split into core-operations digitization and innovative business operations by their relative share of estimated labor costs.

<sup>4</sup>Measured in percentage points, since value from innovation-driven growth is measured as margin expansion.

Source: Independent third-party research data (OmnicomGroup and Known), industry and McKinsey expert interviews, McKinsey D2020 IT cost benchmarking, McKinsey Global Institute research

the potential value of more than 700 use cases involving advanced analytics, IoT, and automation. Here, we categorized use cases as not requiring public cloud and as accelerated or unlocked by public-cloud technology, attributing respective share of value to public cloud. The output was a detailed estimate of value by dimension, benefit driver, and industry.

The third dimension, pioneer, involves exploring business models by experimenting with new and emerging technologies such as blockchain, quantum computing, augmented and virtual reality, and 3-D printing. Given the nascent stage of these technologies, it is far too early to quantify their potential impact over the next decade with any reasonable

precision. We anticipate being able to calculate the impact of this dimension within the next three to five years as case evidence matures.

**For further reading, see the following on McKinsey.com:**

- “Three actions CEOs can take to get value from cloud computing”
- “Debunking seven common myths about cloud”
- “Unlocking value: Four lessons in cloud sourcing and consumption”
- “How CIOs and CTOs can accelerate digital transformations through cloud platforms”
- “Capturing value in the cloud” (collection)

26 essential applications that processed more than \$21 billion in financial transactions each year. When the organization decided to modernize its IT systems, it had to address the challenge of its existing mainframes running on proprietary hardware. The solution was to convert its mainframe applications to software running on modern-day virtualized commodity hardware. The initiative also fully emulated the same levels of integration, interoperability, online interaction, and batch transaction-processing capabilities within the public-cloud environment, reducing operational expenses to 10 percent of the costs to license and support mainframe hardware and software tools, and saving \$5 million annually.

#### **Value driver 2: Improved resilience and lower downtime costs**

By 2030, companies will lose roughly \$650 billion as a result of system downtime and cybersecurity breaches. Through more resilient architecture, cloud could reduce downtime by about 57 percent for migrated applications, resulting in a 26 percent cost reduction for breaches.<sup>7</sup> Cloud could improve platform integrity through automated, embedded security processes and controls (such as DevSecOps). These features reduce tech risks with a modernized, consistent tech stack across environments.

In India, Easy Pay provides local neighborhood shops with a point-of-sale (POS) system that facilitates their payments to a variety of suppliers. Today, the company has a presence in six cities, with a footprint of 650-plus retail points servicing six million unique customers. It is also involved in government-led smart-city projects in cooperation with major Indian banks. Easy Pay launched in 2016 with its own data centers, but its customers felt that processing was too slow, and the system was plagued with unforeseen downtime. Since migrating to cloud, Easy Pay provides close to 100 percent availability, and transaction times have been reduced from 12 seconds to just five. Easy Pay expects at least a fivefold increase in its existing merchant base, from 300,000 to 1.5 million, in fiscal year 2021 and considers cloud a critical enabler of an exponential increase in traffic.<sup>8</sup>

Cerner, a large technology and services provider in the healthcare industry, focuses on data security and compliance. Cloud offers a uniform approach to multifactor authentication, identity management, passwords, and endpoint protection. When the pandemic forced organizations to aggressively move to remote work, cloud made it possible for Cerner to manage virtual desktops securely. The ability to integrate a suite of security services creates a global set of controls that can identify, detect, and investigate advanced threats, compromised identities, and malicious actions across its on-premise and cloud environments, improving its cybersecurity posture.

#### **Value driver 3: Core operations**

Cloud accelerates and, in some instances, unlocks implementation of the latest technological and digitization solutions in the back office, such as analytics-driven accounting and talent management. Organizations that shift to public cloud unlock additional value by repurposing and reskilling their workforce to focus on higher-value tasks, such as developing products and services that address customer demands. Cloud can allow a reduction in manual effort through API-based models, standardization, and automation (for example, infrastructure as code, or IaC).

California Design, an online fashion-bedding brand, depended upon a number of systems to track its complex forecasting and reordering processes. Team members typically planned inventory manually using desktop spreadsheet software, which could lead to excess inventory. Accurately forecasting demand and supply was essential to the company's financial success, but it was also a challenge. The organization migrated its database to a cloud platform and has started leveraging cloud-based vision and machine-learning solutions to reduce inventory carryovers by more than 50 percent, improving the accuracy of demand planning quarter over quarter and gaining granular insights into how individual SKUs are performing.

Aon Securities needed a quantum leap in compute power to efficiently process complex financial

<sup>7</sup> Assuming 50 percent of the estate migrated to cloud.

<sup>8</sup> "EasyPay aims to be USD 100mn revenue company by FY22," *Outlook*, September 23, 2020, outlookindia.com.

modeling. By using on-demand graphical processing units (GPUs) in cloud, the organization gets easy access to large numbers of GPUs and the ability to spin them up quickly and inexpensively, an innovative capability that is a challenge to construct on its own. Now its clients can run and rerun Monte Carlo simulations millions of times with different variables, all in parallel, recalculating policies and trades in minutes rather than hours or days. That frees the business to ask a lot more questions without needing to schedule workloads or to stand up infrastructure.<sup>9</sup>

Global retail-pharmacy giant Walgreens Boots Alliance (WBA) is on a digital-transformation journey. Having migrated its SAP environment to the cloud, WBA can rapidly deploy cloud solutions to 600 to 800 stores per month, while paying only for what it is using to optimize spending. Employees have reported that the system is more responsive, which enables them to work more efficiently and provide a better in-store experience for customers. For example, employees are better able to track and manage inventory, which helps customers find products more easily.

### **Innovate**

The next dimension involves harnessing cloud to accelerate or enable innovation using technologies such as advanced analytics, IoT, and automation at scale. These provide companies with ways to pursue innovation-driven growth and to optimize costs for business operations. The range of potential value is large and reflects the fact that not all organizations have the cloud maturity to achieve a similar degree of innovation. We analyzed 700 use cases to determine the impact of cloud in unlocking value. The value was allocated across a range from 100 percent in select cases, 30 percent in the bulk of cases, and null in a small number of cases (Exhibit 4).

### **Value driver 4: Growth from new and enhanced use cases**

A “fail fast” mentality is a hallmark of the most innovative companies, and cloud facilitates it by providing access on demand to nearly unlimited infrastructure capacity and computational power. Cloud enables companies to experiment with

applications and new business models at lower cost and greater speed. Executives who embrace cloud avoid large up-front capital outlays when they launch or expand businesses. To support this shift, organizations need new operating models focused on, among other things, managing consumption, gaining visibility into future demands, and forming integrated financial operations (FinOps) teams to maintain fiscal control.

New cloud apps tend to draw on ever-evolving large and complex data sets at a much lower cost and at greater speed. In cold-chain distribution, Carrier harnessed new data and sensor technologies to innovate in food and pharma distribution by designing and building a cloud-based logistics network that ensures uninterrupted, temperature-controlled, multimodal transport and storage. Its network’s complexity and vast amounts of data made cloud the only way to bring this vision to life, and the company now hosts up to 70 percent of its computing functions on cloud.

Logistics-and-shipping giant UPS was able to use cloud-based data processing, artificial intelligence (AI), and machine-learning tools to design optimized routing software. When delivering more than 20 million packages a day around the world (more during peak times), UPS drivers make an average of 120 to 125 pickups and drop-offs. The number of possible routes is nearly 200 digits long. Machine-learning models capable of processing one billion data points a day examine package weight, shape, and size, as well as facility capacity across the network, to save UPS up to \$400 million a year and reduce fuel consumption by ten million gallons a year.

Melbourne-headquartered Hanes Australasia sells its products through its approximately 550 stores, 14 websites, and extensive wholesale network. The organization is moving away from a manual, labor-intensive way of recommending products and toward using cloud to offer AI-based recommendations. It has integrated a cloud-based recommendation engine into pages for 10,000-plus products for its popular brands, and initial A/B testing has identified double-digit uplift in revenue per user session. Hanes

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<sup>9</sup>“Aon Securities Inc. case study,” AWS, 2014, [aws.amazon.com](https://aws.amazon.com).

Exhibit 4

## Cloud can accelerate or fully unlock the value of implementing innovative technologies for select use cases.

### Potential value of innovation dimension<sup>1</sup>

700+ use cases were split into three categories by their level of public-cloud dependency ... and then their respective share of value was attributed to the value of public cloud

| Use cases per category, % <sup>2</sup> | Category    | Definition   | Use-case example  | Use-case value for the industry, <sup>3</sup> \$ billion | Public-cloud allocated value, % |   |
|--|-------------|--|---|--|---------------------------------|---|
| 16                                     | Unlocked    | Use cases that cannot be implemented without public cloud due to complexity of the algorithm and data volumes  | <b>Design to value in retail:</b> Using advanced analytics through sentiment analysis, trend modeling, and social listening to predict which products are likely to succeed in private labels                                     | ~15  | 100                             | Full value allocated, given scale of data volume and compute power would be cost prohibitive to stand up on-premise |
| 76                                     | Accelerated | Use cases that can be implemented on-premise but will benefit from cloud capabilities—namely, time to market and scalability   | <b>Predictive maintenance in advanced industries:</b> Predicting defects by managing quality of products and analyzing what drives performance of vehicles  | 6–11   | ~30                             | Partial value allocated, given cloud will expand value via accelerated product development and scalability          |
| 7                                      | On-premise  | Use cases that will not likely benefit incrementally from cloud capabilities and would most likely be implemented on-premise, sensitive to regulation, privacy, bandwidth, and latency | <b>Demand forecasting in healthcare:</b> Forecasting demand for healthcare services and reducing readmissions through targeted discharge setting, due to strong regulations (eg, HIPAA compliance) and relatively low data volume | ~1   | 0                               | None of the value of the use case is allocated to public cloud  |

<sup>1</sup>Also includes core operations in rejuvenation dimension.  
<sup>2</sup>Figures may not sum to 100%, because of rounding.  
<sup>3</sup>Adjusted to Fortune 500 scale.  
 Source: Industry and McKinsey expert interviews, McKinsey Global Institute research

Australasia plans to extend integration to additional sites within its portfolio and to personalize the marketing emails it sends to customers.

#### Value driver 5: Accelerated product development

Companies have adopted cloud to enhance their operating-model agility, which accelerates the implementation of use cases while lowering R&D investment. Companies can more easily configure solutions on cloud than they can on-premise, enabling them to keep pace with the speed of business change and creating a flywheel for responsiveness. In addition, migrating to the public cloud provides organizations with access to

innovative tools and capabilities offered by CSPs, such as containers, microservices, DevOps functions, continuous integration and continuous delivery (CI/CD), and advanced serverless architecture. This enhances product development from the outset and dramatically speeds design, build, and ramp-up, helping companies to dramatically reduce time to market.

To expand into consumer banking, Goldman Sachs launched both its Marcus consumer-lending product and its inaugural credit card with Apple in cloud. The card product required close integration of three different ecosystems to support collaboration

and a seamless user experience. Within six months, the offering had already attracted several million customers and had scaled to meet demand. CEO David Solomon stated, “The only reason we were able to deliver these capabilities digitally and at scale is because of cloud technology.”<sup>10</sup> This success has sparked leadership’s imagination, leading to an ambitious expansion of new offerings as well as enhanced transparency into its operations.

Chevron set up a cloud-readiness acceleration program to expedite its move to cloud. In 18 months, the program expanded from 40 to 450 people across 40 scrum teams. With an automated CI/CD pipeline, Chevron accelerated its cloud migration, the release of new applications, and the delivery of its digital platforms, accommodating around 3,000 active users and 400 live projects. It now delivers code in seven minutes and new infrastructure in as few as 30 minutes, making it faster, easier, and cheaper to deliver new business functionality.

#### **Value driver 6: Rapid scaling**

The infrastructure and global presence of cloud providers can be harnessed to scale products almost instantaneously to a broader set of customer segments, geographies, and channels. In addition, organizations are able to gain access to instant on-demand elasticity in compute and storage capacity—critical elements in launching and building new businesses.

Cloud infrastructure allowed Zoom to efficiently add capacity at the rate of 5,000 to 6,000 servers each night to meet demand during the early days of the COVID-19 pandemic. Says CEO Eric Yuan, “When the pandemic crisis started, our own data centers could not scale fast enough to handle the unprecedented traffic.”<sup>11</sup>

Indonesian e-commerce giant Tokopedia needed a solution for issues with network scalability and reliability. The platform was frequently strained during high-profile online events, most notably for its Tokopedia Play product, which could support only 55,000 concurrent users. Cloud enabled the company to rebuild Tokopedia Play as a microservice in five weeks to support 1.5 million concurrent users.

At the same time, overall operating cost declined due to more effective scaling.

#### **Pioneer**

As its name suggests, pioneer, the third dimension of cloud adoption, is where an enterprise can extend cloud’s value once it has reached a certain level of cloud maturity. At this stage, companies can harness cloud to experiment with new technologies, such as blockchain, quantum computing, augmented and virtual reality, and 3-D printing.

#### **Value driver 7: Adoption of emerging technologies**

With agile operating models, organizations can set up nimble “SWAT teams” to develop proofs of concept. This advanced level of cloud maturity has the additional benefit of attracting and retaining top talent to work on emerging technologies. This is critical as companies seek to incorporate transformative technologies that have not yet achieved mass adoption. While the impact of nascent technologies is difficult to calculate, leaders need to account for potential applications and commit to understanding their potential value. Cloud can accelerate this process.

Nestlé is experimenting with blockchain to achieve unparalleled transparency into its supply chain, from origin to store shelves. The company uses a cloud-native blockchain solution to store supply-chain transactions in ways that are transparent, immutable, and verifiable. Similarly, BMW has implemented blockchain to track a vehicle’s history from manufacture to registration to maintenance to resale.

Quantum computing is expected to provide significant performance improvement and thus potentially disrupt existing business models. By moving infrastructure to cloud and adapting operating models, companies will be better positioned to benefit from cloud-based quantum computing when relevant use cases emerge. CSPs already offer these computing services, which allow organizations to run hybrid quantum and classical algorithms.

Other emerging technologies, such as augmented and virtual reality and 3-D printing, also have immense promise. For example, the health-tech

<sup>10</sup> “AWS re:Invent 2019: David Solomon of Goldman Sachs talks about using AWS to innovate,” AWS, December 4, 2019, video, 3:43, youtube.com.

<sup>11</sup> “Zoom first quarter 2021 earnings webinar: Prepared remarks,” Zoom, June 2, 2020, webinar, investors.zoom.us.

company Axial3D provides clinicians with patient-specific 3-D anatomical models, using a cloud-native integrated development environment for machine learning.

### **What mature cloud adopters get right**

Cloud offers tremendous value, but the benefits don't appear magically. Cloud requires a well-defined, value-oriented strategy and a coordinated execution by IT and businesses to realize full value. For example, organizations that simply "lift and shift" applications to cloud with no change to architecture miss out on key benefits, such as autoscaling and automated performance management. Moreover, success requires a cloud-ready business-technology operating model built around a product life cycle, which improves developer productivity, thereby accelerating product development.

Experience matters, and companies with high cloud maturity exhibit different adoption mindsets than their peers. Third-party primary research on 705 users of public cloud indicates that companies with higher cloud maturity share a number of traits: they are early adopters of cutting-edge technology (71 percent), aggressively innovate (72 percent), and view technology as a competitive differentiator and key enabler for launching and building new businesses (79 percent). By being the first ones to move, these organizations gain considerable experience on cloud, outstripping their peers in cloud outcomes (Exhibit 5).

Building capabilities yields tangible results. Highly mature cloud companies pursue excellence in knowledge and skill sets, which translates into a cloud-literate workforce. To build capabilities within the workforce, these companies create tracks for role and career progression specifically for cloud experts, and they build tailored learning programs to develop cloud-specific skills and competencies. They also ensure that all workers across the enterprise receive on-the-job training about relevant cloud capabilities.

### **Four key actions to get started**

One of the most common mistakes that companies make when integrating cloud is to develop a portfolio of use cases. Individually, these use cases can generate some benefits, but collectively they lack the scale to generate the full potential value. In our experience, the best companies take four steps to create a clear path to cloud-driven performance improvements.<sup>12</sup>

#### **Set an ambitious and urgent business aspiration**

Many leaders know that cloud frees companies from the limitations of traditional technologies, but they remain stuck in outdated models of what they can achieve and set the bar too low. Business and IT leaders should clearly and urgently articulate a high-value ambition—a moon shot achievable when they work closely together on cloud.

#### **Pursue a hard-headed economic case**

A business case for cloud should be grounded in a clear understanding of cloud economics across cost savings (rejuvenate) and business acceleration (innovate). It should be adjusted to transformation risks and prioritized by business domain, and it should include the required resource allocations and sequencing of tasks. One effective approach in developing business-innovation cases is to analyze and articulate the value that can be unlocked or accelerated by cloud. For example, the business-innovation case for an insurer that can refresh its analytical underwriting models twice as fast on public cloud as on a traditional, on-premise infrastructure should calculate both the improvements in return on investment and the value of freeing up capacity for additional innovation. Although the details will vary by organization, we find a holistic, hard-headed business case can help companies gain consensus across functions and build organizational momentum to hit targets within two years.

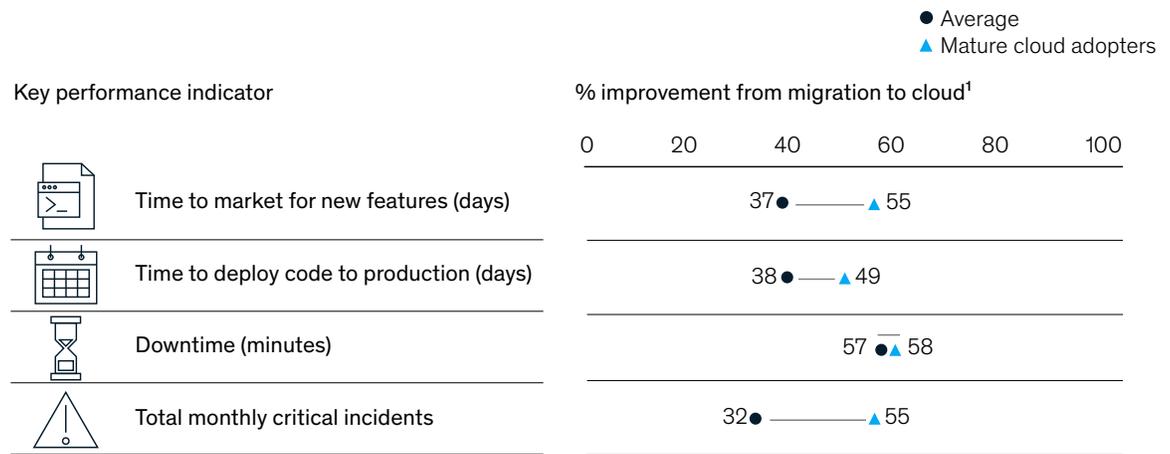
#### **Adopt agile, cloud-native ways of working**

The scope of the change needed to harness cloud requires companies to have real expertise: leaders, staff, and partners with deep experience in cloud and cloud transformations; expert practitioners;

<sup>12</sup> For more, see Jayne Giemzo, Mark Gu, James Kaplan, and Lars Vinter, "How CIOs and CTOs can accelerate digital transformations through cloud platforms," September 2020, McKinsey.com; and Chhavi Arora, Tanguy Catlin, Will Forrest, James Kaplan, and Lars Vinter, "Three actions CEOs can take to get value from cloud computing," July 2020, McKinsey.com.

Exhibit 5

**Mature cloud adopters read larger benefits than average cloud-embracing companies.**



Note: Percentage improvement from migrating to Amazon Web Services (AWS) from on-premise.  
<sup>1</sup>Percentage improvement may vary by level of modernization of on-premise infrastructure and remediation/refactoring of apps before migration to cloud.  
 Source: Data from cloud-migration experience of AWS and independent third-party research data (OmnicomGroup and Known)

and a broad ecosystem. Further, successful cloud efforts are possible only when organizations transform their operations. That includes, for example, a DevSecFinOps approach with small cross-functional teams working within a well-defined architecture to deliver business cases (rather than applications) in rapid iterative cycles, policies that embed security into development, and end-to-end process automation.

**Build a standardized, automated cloud platform**

Invest in creating a standardized, automated cloud platform that improves productivity and delivers a great self-service experience for developers, who are among the primary consumers of cloud. Developers could use automated, API-based services to provision workloads securely and

resiliently on cloud platforms. A higher level of automation also reduces the time needed to prototype new business ideas, which helps businesses innovate and scale rapidly.

The acceleration in digital engendered by COVID-19 is likely to continue far beyond the COVID crisis, and companies must be prepared to respond and adapt rapidly. Cloud can not only help organizations move faster and reduce IT costs but also support innovation and the integration of powerful, disruptive, emerging technologies. However, companies can capture their share of the trillion-dollar prize only when they develop a clear view of the value at stake and the business cases they need to prioritize.

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This article draws on multiple sources of insight and data across sectors, geographies, and technologies, including case examples and data from Amazon Web Services, Google Cloud, and Microsoft Azure. Amazon Web Services also provided access to third-party research.

3

# Cultivate the talent of tomorrow

44

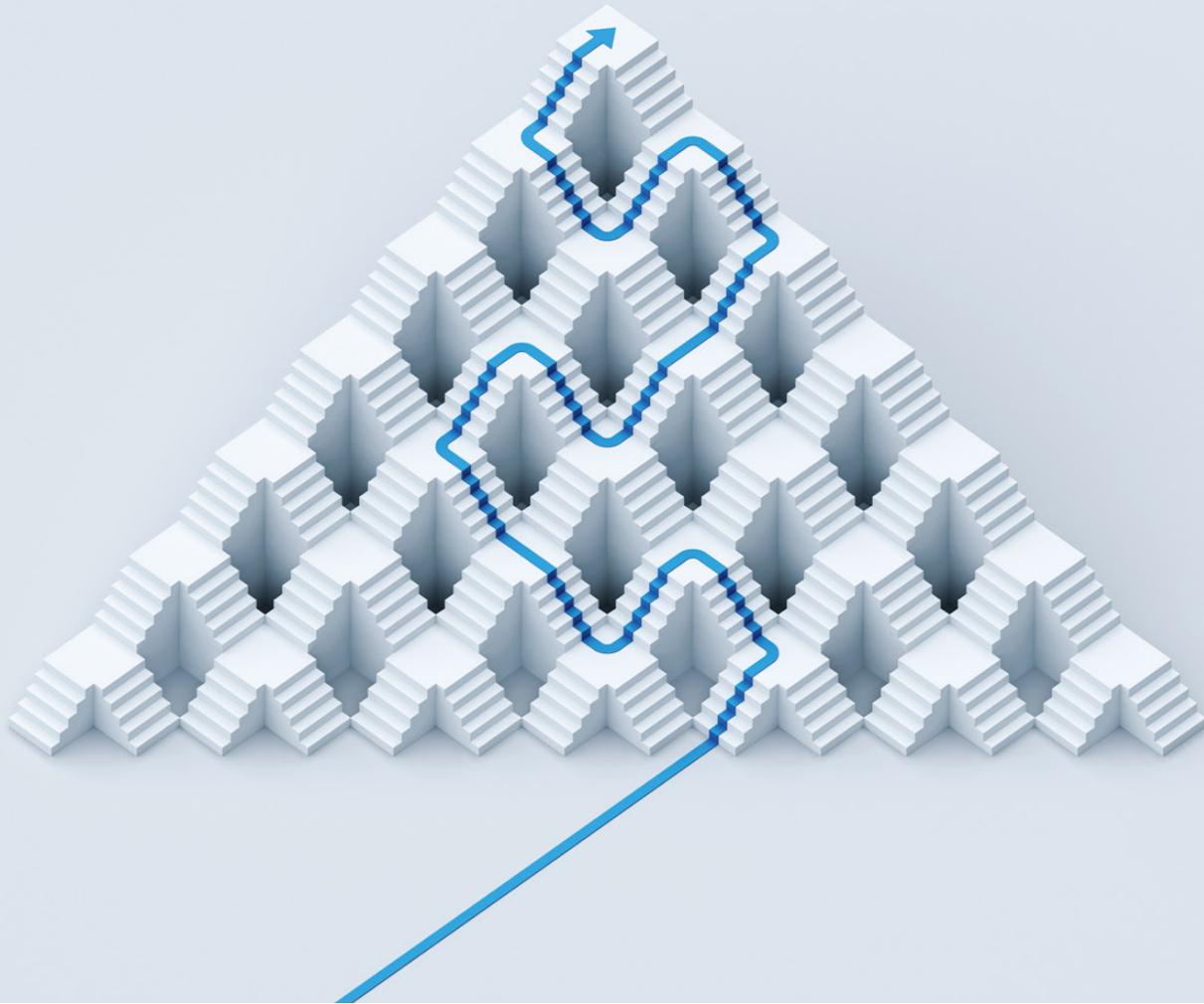
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# The new possible: How HR can help build the organization of the future

The pandemic underscores the urgency for a more dynamic talent and work model. Human-resources leaders can help by focusing on identity, agility, and scalability.

*by Asmus Komm, Florian Pollner, Bill Schaninger, and Surbhi Sikka*

**Business leaders watching** their organizations experience profound upheaval because of the COVID-19 crisis may find it difficult to understand what it all means until the dust settles.

But the pandemic hasn't afforded them, or any of us, that luxury. It has created profound and immediate changes to how societies operate and how individuals interact and work. We have all witnessed an at-scale shift to remote work, the dynamic reallocation of resources, and the acceleration of digitization and automation to meet changing individual and organizational needs.

Organizations have by and large met the challenges of this crisis moment. But as we move toward imagining a postpandemic era, a management system based on old rules—a hierarchy that solves for uniformity, bureaucracy, and control—will no longer be effective. Taking its place should be a model that is more flexible and responsive, built around four interrelated trends: more connection, unprecedented automation, lower transaction costs, and demographic shifts.

To usher in the organization of the future, chief human-resources officers (CHROs) and other leaders should do nothing less than reimagine the basic tenets of organization. Emerging models are creative, adaptable, and antifragile.<sup>1</sup> Corporate purpose fuels bold business moves. “Labor” becomes “talent.” Hierarchies become networks of teams. Competitors become ecosystem collaborators. And companies become more human: inspiring, collaborative, and bent on creating an employee experience that is meaningful and *enjoyable*.

After the pandemic erupted last year, we spoke with 350 HR leaders about the role of uncertainty in their function. They told us that over the next two years they wanted to prioritize initiatives that strengthen their organization's ability to drive change in leadership, culture, and employee experience.

How are they doing? In this article, we discuss ways that CHROs can continue to meet the moment by rethinking processes in three fundamental areas: identity, agility, and scalability.

## **How HR fits in the big picture**

McKinsey has recently conducted research on how businesses can best organize for the future.<sup>2</sup> The experimentation under way suggests that future-ready companies share three characteristics: they know what they are and what they stand for; they operate with a fixation on speed and simplicity; and they grow by scaling up their ability to learn and innovate.

HR can help propel this transformation by facilitating positive change in these three key areas, as well as with nine imperatives that radiate out from them (Exhibit 1).

## **Identity: HR can clarify the meaning of purpose, value, and culture**

Companies that execute with purpose have greater odds of creating significant long-term value generation, which can lead to stronger financial performance, increased employee engagement, and higher customer trust.

### **Home in on the organization's purpose**

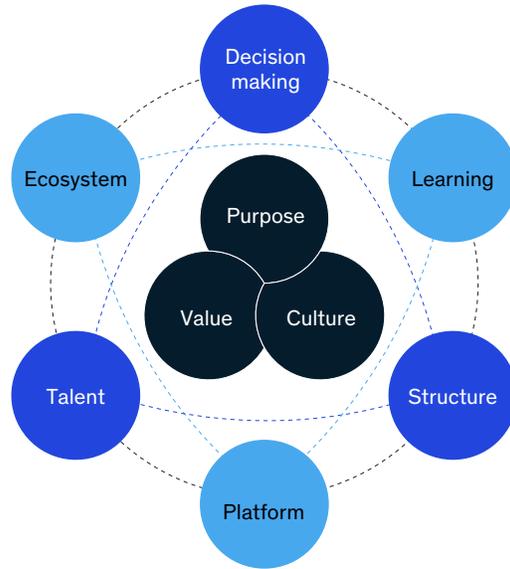
What is your company's core reason for being, and where can you have a unique, positive impact on society? Now, more than ever, you need good answers to those questions—purpose is not a choice but a necessity.

CHROs play a vital role in making sure the organization is living its purpose and values. HR can articulate and role-model desired individual mindsets and behaviors linked to purpose by identifying “moments that matter” in the company's culture and by translating purpose into a set of leadership and employee norms and behaviors.

<sup>1</sup>Nassim Nicholas Taleb, *Antifragile: Things That Gain from Disorder*, New York, NY: Random House Trade Paperbacks, 2012.

<sup>2</sup>Aaron De Smet, Chris Gagnon, and Elizabeth Mygatt, “Organizing for the future: Nine keys to becoming a future-ready company,” January 11, 2021, McKinsey.com.

**Nine imperatives can help HR leaders ready their organizations for the future.**



- **Who we are**  
Being clear about organization's "why," "what," and "how": why it exists, what it does, and how it runs
- **How we operate**  
Flattening the organization with teams that make fast decisions and treat people as the scarcer capital
- **How we grow**  
Get ahead and stay there by outlearning others, reaping value from data, and utilizing the ecosystem to drive value creation

● HR driving    ○ HR facilitating

**Purpose**

- Establishing and radiating the organization's purpose

**Culture**

- Taking employee experience (including their work spaces) to the next level
- Driving leadership and culture

**Value**

- Rebalancing talent resources; mapping talent to value

**Decision making**

- Capturing speed in decision making from crisis operations (eg, COVID-19 era)

**Structure**

- Adopting new models; simplifying the organization
- Making the workforce more flexible; reducing employee cost

**Talent**

- Driving strategic workforce planning and talent magnetism
- Introducing next-generation performance management

**Learning**

- Reskilling and upskilling talent; creating a learning culture

**Platform**

- Building an agile, digital HR platform

**Ecosystem**

- Collaborating with HR-tech players and others in the wider HR ecosystem

For instance, commercial-vehicle manufacturer Scania holds an annual "Climate Day," during which the company stops operations for one hour to hold sustainability training, in line with its purpose to "drive the shift toward a sustainable transport system."<sup>3</sup>

HR can also ensure that clear changes are made to recruitment and capability-building processes by determining the characteristics of a purpose-driven employee and embedding these attributes within recruitment, development, and succession planning.

<sup>3</sup>Scania Annual and Sustainability Report 2019, Scania, scania.com.

HR can also incorporate purpose-driven metrics into compensation and performance decisions. Companies across industries have recently embarked on these metrics. For example, Seventh Generation, a maker of cleaning and personal-care products, recently built into its incentive system sustainability targets for the company's entire workforce in service of its goal of being a zero-waste company by 2025. Shell has plans to set short-term carbon-emissions targets and link executive compensation to performance against them.

### **Think deeply about talent**

Organizations that can reallocate talent in step with their strategic plans are more than twice as likely to outperform their peers. To link talent to value, the best talent should be shifted into critical value-driving roles. That means moving away from a traditional approach, in which critical roles and talent are interchangeable and based on hierarchy.

Getting the best people into the most important roles requires a disciplined look at where the organization really creates value and how top talent contributes. Consider Tesla's effort to create a culture of fast-moving innovation, or Apple's obsessive focus on user experience. These cultural priorities are at the core of these companies' value agendas. The roles needed to turn such priorities into value are often related to R&D and filled with talented, creative people.

To enable this shift, HR should manage talent rigorously by building an analytics capability to mine data to hire, develop, and retain the best employees. HR business partners, who articulate these staffing needs to the executive management team, should consider themselves internal service providers that ensure high returns on human-capital investments. For example, to engage business leaders in a regular review of talent, they can develop semiautomated data dashboards that track the most important metrics for critical roles.

### **Create the best employee experience possible**

Companies know that a better employee experience means a better bottom line. Successful organizations work together with their people to create personalized, authentic, and motivating experiences that tap into purpose to strengthen individual, team, and company performance.

The HR team plays a crucial role in forming employee experience. Organizations in which HR facilitates a positive employee experience are 1.3 times more likely to report organizational outperformance, McKinsey research has shown. This has become even more important throughout the pandemic, as organizations work to build team morale and positive mindsets.

HR should facilitate and coordinate employee experience. Organizations can support this by helping HR evolve, strengthening its capability so that it becomes the architect of the employee experience. Airbnb, for instance, rebranded the CHRO role as global head of employee experience. PayPal focused on HR's capability and processes to create a better experience for employees, including coaching HR professionals on measuring and understanding that experience and using technology more effectively.

### **Strengthen leadership and build capacity for change**

Culture is the foundation on which exceptional financial performance is built. Companies with top-quartile cultures (as measured by McKinsey's Organizational Health Index) post a return to shareholders 60 percent higher than median companies and 200 percent higher than those in the bottom quartile.

Culture change should be business-led, with clear and highly visible leadership from the top, and execution should be rigorous and consistent. Companies are more than five times more likely to have a successful transformation when leaders

have role-modeled the behavior changes they were asking their employees to make.

To strengthen an organization's identity, HR should ask the following questions:

- How can we develop an energizing sense of purpose that has a tangible impact on our strategic choices and ways of working?
- How can we identify key talent roles and focus them on creating value?
- How can we build a data-driven, systemic understanding of our organizational health?

### **Agility: HR's role in flattening the organization**

Organizational agility improves both company performance and employee satisfaction. HR can be instrumental in shifting an organization from a traditional hierarchy to a marketplace that provides talent and resources to a collection of empowered small teams, helping them to achieve their missions and acting as a common guiding star.

#### **Adopt new organizational models**

For instance, as a part of a multiyear agile transformation, a large European bank worked to establish an in-house agile academy led jointly by coaches and the HR function to drive capability building for the transformation.

To be successful, a transformation should touch every facet of an organization—people, process, strategy, structure, and technology. HR can help create an iterative approach by developing core elements of the people-management process, including new career paths for agile teams, revamped performance management, and capability building. It should lead by example as well by shifting to agile “flow to work” pools in which individuals are staffed to prioritized tasks.

#### **Create a flexible—and magnetic—workforce**

Because many roles are becoming disaggregated and fluid, work will increasingly be defined in terms of skills. The accelerating pace of technological change is widening skills gaps, making them more common and more quick to develop. To survive and deliver on their strategic objectives, all organizations will need to reskill and upskill significant portions of their workforce over the next ten years.

According to a 2018 McKinsey survey, 66 percent of executives said that “addressing potential skills gaps related to automation/digitization” within their workforces was at least a “top ten priority.” HR should help prioritize these talent shifts.

In a more recent survey McKinsey conducted with global executives about the postpandemic workforce, more than a third of respondents said that their organizations were unprepared to address the skills gaps exacerbated by automation and digitization. The shift to digitization has accelerated during the pandemic: 85 percent of companies have picked up the pace of their digitization (including a 48 percent rise in the digitization of customer channels). In light of these trends and the need to shift skills, there is a clear business rationale behind workforce strategy and planning.

HR should be a strategic partner for the business in this regard by ensuring that the right talent is in place to deliver on core company objectives. HR can also drive workforce planning by reviewing how disruptive trends affect employees, identifying future core capabilities, and assessing how supply and demand apply to future skills gaps.

Moving to a skills focus also requires innovative sourcing to meet specific work-activity needs (for example, the gig economy and automation), and changing which roles companies need to source with traditional full-time-equivalent positions

and which can be done by temporary workers or contractors. In the survey with global executives, about 70 percent said that two years from now they expect to use more temporary workers and contractors than they did before the COVID-19 crisis.

During the pandemic, we've seen how organizations have come together to utilize talent with transferable skills. For instance, McKinsey has supported Talent Exchange, a platform that uses artificial intelligence to help workers displaced by the crisis.

### **Make better decisions—faster**

Companies that make decisions at the right organizational level and that have fewer reporting layers are more likely to deliver consistently on quality, velocity, and performance outcomes and thus outperform their industry peers. The pandemic has trained the spotlight on the power of fast decision making, as many organizations have had to move dramatically more quickly than they had originally envisioned. For example, one retailer had a plan for curbside delivery that would take 18 months to roll out; once the COVID-19 crisis hit, the plan went operational in just two days.

HR can help with strong decision making by empowering employees to take risks in a culture that rewards them for doing so. McKinsey research revealed that employees who are empowered to make decisions and who receive sufficient coaching from leaders were three times more likely to say that their companies' delegated decisions were both high quality and speedy.

### **Introduce next-generation performance management**

Companies are experimenting with a wide variety of approaches to improve how they manage performance. According to a McKinsey Global Survey, half of respondents said that performance management had not had a positive effect on employee or organizational performance. Two-thirds reported the implementation of at least one meaningful modification to their performance-management systems.

We identified three practices—managers' coaching, linking employee goals to business priorities, and differentiated compensation—that increase the chances that a performance-management system will positively affect employee performance. HR plays an important role in embedding these practices in performance management by supporting the goal-setting process, decoupling the compensation and development discussion, investing in manager's capability building, and embedding technology and analytics to simplify the performance-management process.

To strengthen an organization's agility, HR should ask the following questions:

- Can we enable more effective decision making by pushing decisions to the edges of the organization, creating psychological safety that empowers people, and building capabilities?
- How do we accelerate the shift to a more diverse and deeply motivated talent base, one that is supported through a human-centric culture that enables outperformance and superior experience?
- Which organizational areas or end-to-end value-creation streams would most benefit from a shift to new ways of working and organizing?

### **Scalability: How HR can drive value creation**

The new normal of large, rapidly recurring skills gaps means that reskilling efforts must be transformational, not "business as usual" or piecemeal.

### **Lean into a learning culture by reskilling and upskilling**

Effective reskilling and upskilling will require employees to embark on a blended-learning journey that includes traditional learning (training, digital courses, job aids) with nontraditional methods (enhanced peer coaching, learning networks, the mass personalization of change, "nudging" techniques).

For instance, Microsoft shifted from a “know it all” to a “learn it all” ethos, incorporating open learning days, informal social learning opportunities, learning data for internal career paths, and new platforms and products for its partner network.

### **Memo to HR: Look in the mirror**

To drive and facilitate these workforce initiatives, HR must transform itself first. Talent is consistently ranked as a top three priority for CEOs, yet many lack confidence in HR’s ability to deliver.<sup>4</sup> The HR function is often overburdened with transactional work and not well equipped to create value for the enterprise.

Yet people-first organizations look at business problems from the perspective of how talent creates value, and HR is well positioned to bring data-driven insights to talent decisions. HR can arm itself with data-driven insights and people analytics to support talent-driven transformation, and HR business partners can then consistently make talent decisions based on data.

### **Create a value-enhancing HR ecosystem**

McKinsey analysis has shown that a preponderance of executives recognize how much external partnerships help companies differentiate themselves. Increased value can be created through ecosystems where partners share data, code, and skills. Success now requires “blurry boundaries” and mutually dependent relationships to share value.

The need of the hour is for HR to collaborate on and leverage the landscape of HR tech solutions across the employee life cycle—from learning, talent acquisition, and performance management to workforce productivity—to build an effective HR ecosystem.

To strengthen an organization’s scalability, HR should ask the following questions:

- How can we set up platforms spanning multiple players in the ecosystem and enable new

sources of value and employee experience through them?

- How can we become the best company to partner with in the ecosystem? How can we set ourselves up for fast partnering and make the ecosystem accessible?
- What are the critical skills that drive future value creation and how can we upskill our talent base accordingly?

### **Looking ahead: How transformation happens**

As the organization of the future takes shape, HR will be the driving force for many initiatives: mapping talent to value; making the workforce more flexible; prioritizing strategic workforce planning, performance management, and reskilling; building an HR platform; and developing an HR tech ecosystem. For other initiatives, HR can help C-suite leaders push forward on establishing and radiating purpose, improving employee experience, driving leadership and culture, and simplifying the organization.

Given the magnitude of the task and the broad portfolio of value-creating HR initiatives, prioritization is critical.

In May of 2020, HR leaders attending a McKinsey virtual conference indicated that over the next two years, they wanted to prioritize initiatives that strengthen agility and identity. That included 27 percent who said that they would focus on responding with agility and 25 percent who prioritized driving leadership, culture, and employee experience. Next came mapping talent to value and establishing and radiating purpose, each at 13 percent (Exhibit 2).

At a second conference for HR leaders,<sup>5</sup> about half of the assembled CHROs said that they were focusing on reimagining the fundamentals of the organization and rethinking the operating model and ways of working in the next normal.

<sup>4</sup>Dominic Barton, Dennis Carey, and Ram Charan, “People before strategy: A new role for the CHRO,” *Harvard Business Review*, July–August 2015, Volume 93, Number 7–8, pp. 62–71, hbr.org.

<sup>5</sup>Survey of human-resources leaders at “Reimagine: Organizing for the future,” a McKinsey virtual conference held in June 2020.

Exhibit 2

**HR leaders say they are prioritizing initiatives that strengthen agility and identity.**

**Initiative selected by HR leaders as a top 3 priority for the next 18–24 months, %<sup>1</sup>**

| Responding with agility | Driving leadership, culture, and employee experience | Mapping talent to value | Establishing and radiating purpose | Simplifying the organization | Virtualizing work and its implications | Other |
|-------------------------|--|-------------------------|------------------------------------|------------------------------|--|-------|
| 27                      | 25   | 13                      | 13                                 | 9                            | 5                                      | 8     |

100%

<sup>1</sup>Of 268 selected initiatives; question: As an HR leader, what are your top 3 priorities for the next 18–24 months?  
Source: HR Leader Survey, The Role of HR During Uncertainty and Beyond, virtual conference, May 2020

We see organizations making this shift. Throughout the pandemic, HR has played a central role in how companies build organizational resilience and drive value. CHROs and their teams can continue on this path by connecting talent to business strategy and by implementing changes in the three core areas of identity, agility, and scalability, as well as the nine imperatives that flow from them.

A more flexible and responsive model will also help organizations meet coming demographic shifts and other workforce changes. Millennials are becoming the dominant group in the workforce (with Gen Z close behind), creating novel challenges for organizations to meet their needs. The prominence of the gig economy and alternate models of working will only grow, with 162 million workers in the European Union and the United States working independently—70 percent of them by choice. And the rapid spread of digital technology and

automation is dramatically reshaping the global economy, with half the tasks people perform already automatable today.

These trends are not new, but they are approaching tipping points, placing organization at the top of the CEO agenda. CHROs can help leadership by transforming their own HR organizations: developing and reinforcing clear priorities; embracing new ways of working, including rapid iteration and testing with the business and seeking explicit feedback; and revamping the HR skill set by embracing agility and digital capabilities.

While clearly a trial by fire, the pandemic also provides an opportunity for HR to accelerate its shift from a service to a strategic function, helping to shape a more dynamic organization that is ready to meet the postcrisis future.

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The authors wish to thank Talha Khan for his contributions to this article.

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# Tackling Asia's talent challenge: How to adapt to a digital future

McKinsey's Oliver Tonby, Li-Kai Chen, and Anu Madgavkar discuss the opportunity—and obligation—to reimagine the workforce of the future.

**Asia's steady trot** toward a digital-first future has accelerated into a gallop. With the COVID-19 pandemic catalyzing forces already at play in Asia, 78 million workers across China, India, and Japan will have to adapt to the proliferation of automation technologies and other forms of innovation, according to research by the McKinsey Global Institute.

How should business leaders, policy makers, and employees in Southeast Asia prepare for this great transition? That was the topic of discussion in a virtual roundtable led by Oliver Tonby, chairman of McKinsey Asia, with Li-Kai Chen, managing partner of the Malaysia office, and Anu Madgavkar, a partner with the McKinsey Global Institute, this May.

The increased pace of automation has made reskilling an urgent priority, an endeavor that requires a coordinated effort on multiple levels. The following outlines the key themes surfaced during the conversation.

### **Impact of COVID-19: Remote work is only the start**

Remote work was only the first in a number of profound changes accelerated by the COVID-19 crisis. During the pandemic, mobility constraints compelled businesses to find digital ways to replace in-person interaction—from virtual meetings and e-commerce to digital supply chains and digital sales and marketing—and many companies are now thinking about how to apply the lessons learned to a hybrid scenario. “Employees actually like the flexibility, and employers are willing to look at remote work as a new way of securing talent and improving their talent value proposition,” says Madgavkar.

Madgavkar projects that the use of automation technology to minimize physical movement and interaction will likely pick up steam in the next 18 to 24 months. However, Asia's diverse demographic and economic mix means that changes will not be uniform everywhere. In Asia, around 20 to 25 percent of workers will be able to work away from physical offices, although the figure for Southeast Asia will likely range between 5 and 10 percent. That said, even for a country like Malaysia, where

automation is not expected to be as prevalent, Chen estimates that “about 60 percent of jobs will likely have 30 percent of activities that can be automated.”

### **Supporting and reskilling workers for new opportunities**

Widespread automation will inevitably displace jobs even as it creates new ones. Repetitive, manual tasks and functions requiring only basic cognitive skills such as data input and processing are most at risk of becoming obsolete. According to a McKinsey Global Institute study of eight countries, more than 100 million workers will be affected, including 18 million in India and around 50 million in China. “It can probably be quite traumatic for the person whose job is being displaced,” observes Tonby.

It's imperative, therefore, for reskilling to be an integral part of planning for the future. The skills that will be most important going forward are those that are not easily replaced. “These include technology skills, basic computer and digital skills, advanced cognitive skills, quantitative and statistical skills, and problem-solving skills,” says Chen. Other traits that will rise in importance include interpersonal skills to foster relationships across various stakeholders.

Reskilling a workforce of millions is no easy feat, but similar shifts in history have led to positive outcomes. “Every time there's an occupation transition, it potentially enables workers to do higher value work, be more productive, earn more, and do less drudgery,” says Madgavkar. For instance, as self-service kiosks become more commonplace in banks, a bank teller's role may evolve to helping customers troubleshoot problems, doing some cross-selling, or cultivating client relationships.

### **Embarking on the transition: How should governments, companies, and employees think about this?**

The transition presents many opportunities, and Asia is well positioned to lead the rest of the world in terms of digital transformation, as three-quarters of all STEM graduates hail from the region.

*Governments* could think beyond offsetting job losses and look at the transition as a way to generate new jobs. The two main areas to pay attention to are communications infrastructure and inclusive and accessible education. “We can’t have half the population left out because they don’t have access to low-cost and high-speed internet, or if they don’t have access to skills to navigate the digital environment,” says Madgavkar. According to Chen, approximately three million to four million workers in Malaysia will benefit from new roles, thanks to initiatives such as MyDigital blueprint. The scheme consists of a slew of national development policies aimed at catalyzing the nation’s digital economy. Singapore, meanwhile, has a SkillsFuture effort that is aimed at helping workers in the country learn new skills.

*Companies* could explore avenues to empower their staff to be more agile and productive, focusing on especially vulnerable segments such as women, new joiners, and those with fewer formal qualifications. Women, for instance, have been disproportionately disadvantaged by the pandemic, even though they have the potential to be great drivers of value. Tonby points out that a disproportionate number of women are spearheading the micro-, small-, and medium-size enterprise segment in Indonesia’s tech landscape.

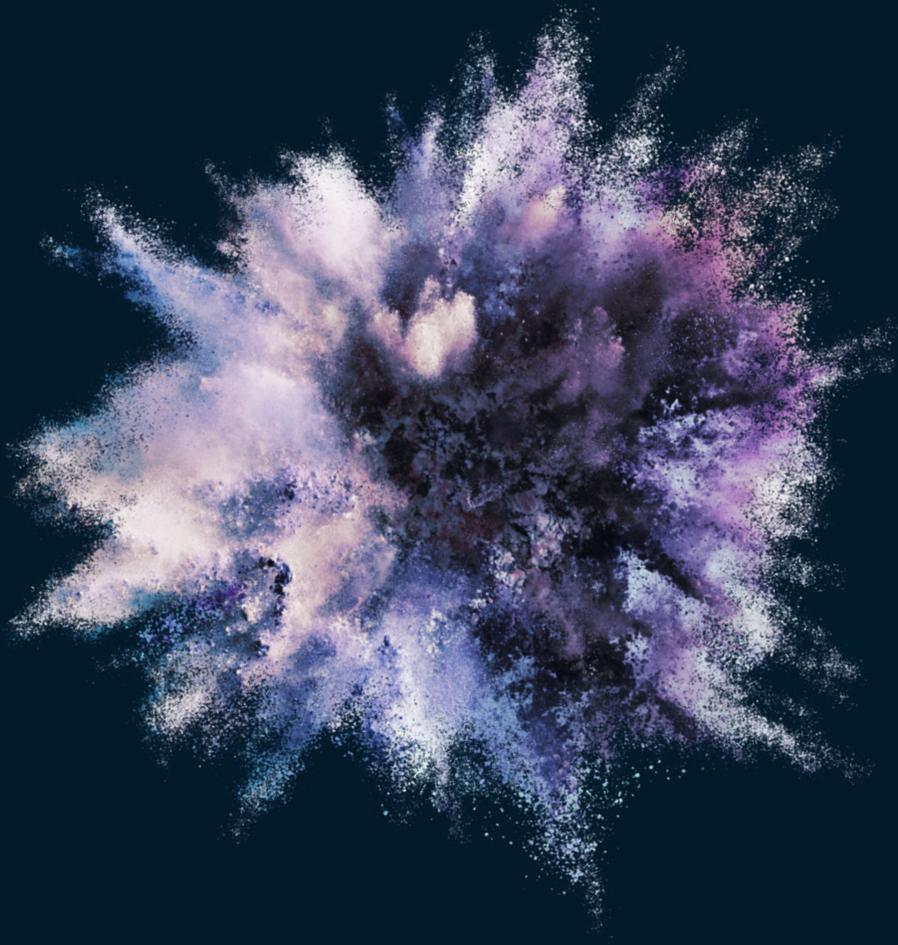
Companies also have to play an increasingly proactive role in upskilling their employees so that they can adapt to new changes in technology instead of relying too much on external hires. “We should not be trapped into defining suitability for work based on traditional degrees or time- and

cost-intensive ways of educating people,” explains Madgavkar. Instead, employers should adopt a more agile approach and define the specific skill types required. Then they can leverage digital technology to offer workers specific programs to equip them with the necessary skill set. Extra thought should also be given to the lower-skilled workforce, such as delivery jobs. As e-commerce grows in prominence, companies could investigate ways to equip this segment with the professional qualifications needed to perform these jobs well and make sure that credentials are recognized as workers move from job to job.

Finally, *employees and workers* have to recognize that they’re due for a mindset shift when it comes to their careers. Chen cites research showing that millennials change jobs more than four times in the first decade of their careers—more than double the rate of their parents’ generation. Another seismic change is on the horizon: employees will have to fundamentally overhaul their skill sets several times for each job they hold to keep pace with changing skill requirements. “The speed of reskilling is going to be quite vital for a new joiner to today’s workforce. Lifelong learning is here to stay,” says Chen. “How do you learn to learn?”

Ultimately, while the journey of talent transition is not without its challenges, the roundtable participants agree that it’s especially important that senior executives, leaders, and policy makers do not lose sight of the prize: greater agility, productivity, and empowerment of the workforce. As Chen aptly sums up: “This is both an opportunity and an obligation to reimagine a future of work.”

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# The new science of talent: From roles to returns

Getting the right people into the right roles is more vital than ever. Here's how to deliver returns on talent faster—and help more women rise to the C-suite at the same time.

**McKinsey leaders** Bryan Hancock and Bill Schaninger spoke with McKinsey Publishing's Lucia Rahilly about why, in a world in flux, talent matters more than ever, and how to match the right people with the roles likeliest to deliver value. This is an edited version of their conversation.

## Talent in a changing world

**Lucia Rahilly:** Everyone's talking about the future of work and the potential for automation and artificial intelligence [AI] to transform working as we know it. But talent and talent shortages are not new issues. Why this disconnect in making human capital as high a priority as financial capital?

**Bill Schaninger:** It's an interesting conundrum. When we ask people if they have enough talent, they almost universally say no. Then they go back to looking at KPIs [key performance indicators] for that quarter's performance.

We've created a managerial system and reporting mechanism that disproportionately focus on financial capital, not human capital. Leaders haven't spent nearly enough time asking, "What are the critical roles? What are the critical skills?" They need to reboot how they lead, with equal, if not greater, emphasis on the scarce capital—human capital.

**Lucia Rahilly:** How do digitization and AI compound the challenge, and what's at stake for companies that don't get this right?

**Bryan Hancock:** When we've worked with CEOs on setting the value agenda and determining where new value will come from, 70 to 80 percent might involve building a digital business or capability. That's where we find gaps. When we do that analysis, we're looking at the top 25 to 50 roles that drive disproportionate value. We break down the value agenda and ask, "How are we going to make money in the future?" Some parts will be new. Others will be sustaining. What's new is disproportionately in the digital space.

**Bill Schaninger:** Bryan mentioned "value agenda." It's important to understand what that means. There's a basic way of asking, "What's our business

as usual? How does the business make money today?" You could take an organization chart and write the revenue or profit number in the boxes all the way down. That's protecting the core.

Companies trying to improve might say, "We have three or four things going on across the company—procurement, pricing, lean management. They're relatively small numbers for each unit, but when we add them up, that's a big number. Should we think about a role there?" That's improving the base business.

Then you get into the interesting thing Bryan is talking about: "net new." Look at the company today, draw a box, and say, "That one is consumer into China. This one is the new digital platform." They don't yet exist, but if you have money, write the numbers in. Because the minute you ask for capital or make a commitment to the board, you're on the hook for that number. That's what the role should count for.

## From roles to returns

**Lucia Rahilly:** You're a CEO, and you ask yourself, "What does my supply–demand ratio look like: Am I long, am I short on talent?" What's your first step?

**Bryan Hancock:** We sometimes look at value levers and initiatives individually, figuring out where roles and value are. But CEOs, or CFOs, or CHROs [chief human-resources officers] think at a different level of aggregation, different chunks.

One leadership team was recently talking about this in three ways. First, "Hey, I have this new attacker business I need to create. Over time, it may take over. But I want it to be unconstrained by current processes, current IT platforms. And I need somebody to lead that business." That's the net new.

Second, "I'm interested in digital, automation, and the future of work. To make that happen, I need more people in digital areas and fewer people in routine work. Most important are the people designing new tech tools, and maybe one or two driving implementation."



'It's a unique opportunity when you recast how you're going to make money ... to maximize [it], you should acknowledge that, of the people who got you *here*, some of them are just not going to get you *there*.'

—Bill Schaninger

Third, "There's a part of the business that's not net new, that's not being hit by the future of work. Procurement is my number-one value capture. I need to make sure I have the best procurement person in the world."

By breaking it into those three chunks, you can say, "OK, I have the value agenda, plus the enablers and pieces and how they fit with the three parts of my agenda."

**Bill Schaninger:** One point here is that we regularly confuse people with roles and confuse talent with broad skill pools. In many organizations, roles today bear no resemblance to what they'd look like if you were designing them from scratch. Get clear in your head: What are the few critical roles? There are probably a couple dozen. That's it.

Everything else probably sits in a skill pool, a clustering of common skills deployed in different

ways. That starts looking more homogeneous. If it starts looking more homogeneous, you can start finding types of people, not a person. One of the toughest conversations happens if you find out you're long—that you have too many people.

**Lucia Rahilly:** What does that mean when you're mapping current roles against future roles, and how do you get there?

**Bill Schaninger:** Take the incumbent out of it. We're more likely to try to make the role fit the person, which is the 180 of what we're trying to accomplish—which is to get clear on the role and then decide whether the person fits.

It's a unique opportunity when you recast how you're going to make money and run the place. To maximize that opportunity, you should acknowledge that, of the people who got you *here*, some of them are just not going to get you *there*. That's the challenge with incumbency.

**Bryan Hancock:** Asking CEOs about their biggest regret, the answer we hear time and again is not moving fast enough on talent. We recently looked at 170 deals within one private-equity [PE] firm's portfolio. Fewer than half of CEOs made it all the way through. But those firms that moved faster to change their leadership had higher first-year returns, higher second-year returns, and higher total returns on exit.

So let's bring science to that. Let's figure out exactly what you need new folks to do and assess against it. If the incumbent is great, *great*. If not, you're going to realize it in six months or 18 months or 24 months. A better fit drives better returns.

**Bill Schaninger:** Every time we talk about what kind of person you need, or whether the person fits, we're talking about assessment at its core. Many organizations have no problem assessing people coming in the door. But they get uncomfortable

assessing incumbents. They think, "These are the cards I have."

Well, you could find a different role for them. Wouldn't they be better suited to being in a role more closely aligned with their skills and aspirations? Sometimes we convince people they're on a track and have to stay there, and they're not happy about it. They need to be liberated as well.

## The science of soft skills

**Bryan Hancock:** I think we've spent the past 150 years making people more like machines. Think about *Office Space* and TPS reports<sup>1</sup> coming back. That was funny because that's how offices worked back then, much like manufacturing. Now those TPS reports are automated.

What's important now is a different set of skills: interpersonal skills, creativity, qualities that are more innately human. How a company invests in individuals—it's no longer, "Hey, can I teach you exactly how to fill out the TPS report?" Instead, it's, "How can I teach you social-interaction skills? How can I help you progress as a human being?"

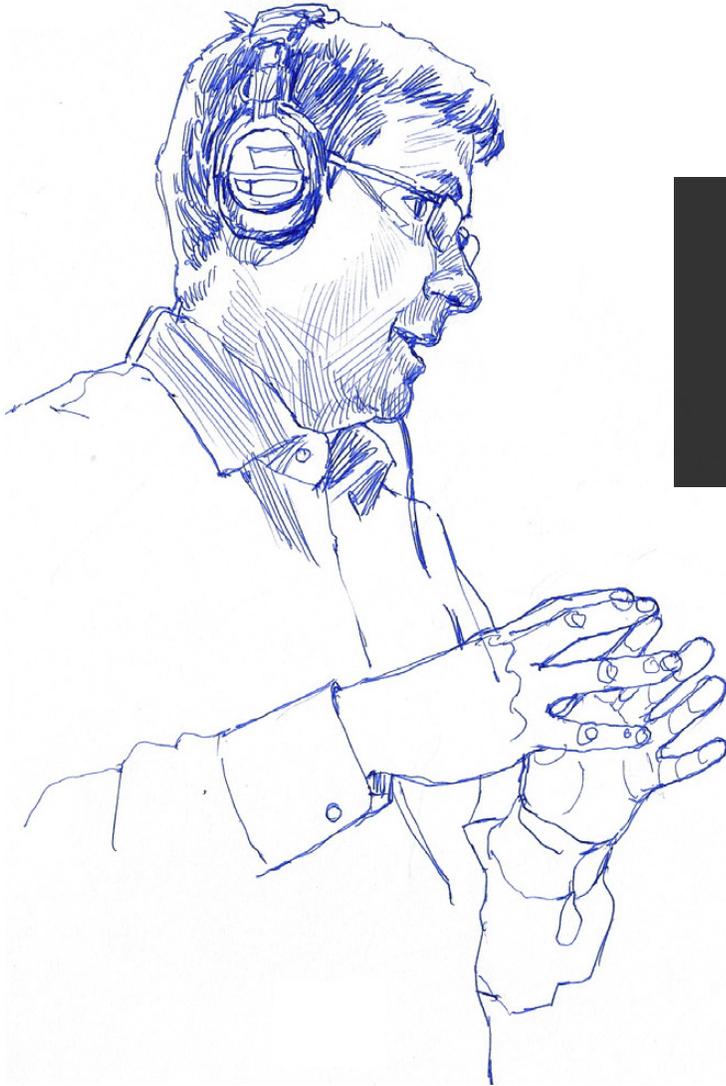
More broadly, the conversation is changing from, "As human replacement for machine, what's the hourly rate I'm going to negotiate with you?" to, "How do we think about developing people so that in a changing world of work, our workers can adapt alongside the company and we do this together?" It's different. Wages and benefits are still important. But recognizing the broader human-development piece is interesting and fruitful to explore.

**Lucia Rahilly:** How can these soft skills effectively be assessed?

**Bill Schaninger:** That's a great question, and one we spend a ton of time on. Since I've joined McKinsey, we've seen an absolute shift in how we

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<sup>1</sup> After the use of "TPS reports" in the 1999 comedy film *Office Space*, the term (referring to test, program, and set or to testing procedure specification) came to convey tedious documentation or paperwork.



'... if we make [the CHRO] a value role, it should become a core source of talent for the next generation of women CEOs.'

—Bryan Hancock

think about assessing human potential, personality, and performance.

There are still some basics. You can start with what you can see directly. You're either a professional engineer or not; you're a CPA [certified public accountant], or you're not; you know how to code in Python, or you don't. But attributes, personality—those have seen a ton of change. Sometimes you used to be unsure after long, laborious validation procedures. Now we're seeing cool things like gamification. It's amazing.

First question about games: How do you take gender out of them? Don't make them about shooting, blowing things up, or playing sports. Make them about problem solving. Then it's not just the results. We're interested in how you take in information, the speed at which you make choices, how much you're willing to take risks.

There was a game in our age called *SimCity* [a city-building video-game series]. I loved it. I wanted to understand the algorithm. I would go to the tax bar and keep raising it—taking the tax all the way up

until I got a riot because a riot became destabilizing and you couldn't build anything. But if you kept it just below a riot, you'd maximize revenue.

Why bring that up? That's about my own risk tolerance and the way I explored data before making decisions. Someone more impulsive wouldn't have bothered to try to find the outer marker. With something as engaging as a game, we can find out a lot about a person. So now we're marrying assessment with the potential employee experience and getting a wealth of knowledge.

**Lucia Rahilly:** Is this the tech equivalent of how many ping-pong balls will fit in a 747?

**Bryan Hancock:** For some games, yes. Others cue on different things, like social awareness and the ability to identify emotions in others. There's a game by KnackApp called *Wasabi Waiter*. You're a waiter in a Japanese restaurant, and the kitchen gets backed up. You have a process you're supposed to follow. Are you somebody who follows the rules even though the kitchen is backed up? How quickly do you notice someone fuming on one side? How quickly do you get social cues? You can see patterns—not just the order but also the speed at which you pick up cues, how quickly you move different pieces. One game can create thousands of points of data.

Then, by comparing with others who've played and are successful in their roles, you can say, "Hey, the people who picked up on these things earlier look a lot like people who are good in this kind of consultative sale."

**Bill Schaninger:** Here's another example: Let's say I put a Lego set down. Some people build it as specified. Others can't imagine doing that. They empty the pieces out, look at the picture, and say, "I can make it better." That shows whether you're a rule follower or not. Some jobs need rule followers. Some need creative thinkers.

What happens if you put the set between two people? How do they divvy up the work? If you want to know whether someone's naturally facile at

working with others, give them a task without any instruction on how to divide the work. Do you just break it up and say, "I'll do the first bit; you do the second bit"?

**Lucia Rahilly:** There's a gender component there, though. That dynamic can be overtaken by an alpha guy.

**Bill Schaninger:** For sure.

**Bryan Hancock:** You're going right to the heart of assessment. In designing assessments, how do you be clear on what you're measuring and make sure you don't have any bias built in? That's core. In the case Bill talked about, if the assessment was well constructed, you may be looking to weed out dominant behavior.

## A new mindset for CHROs

**Lucia Rahilly:** Let's get back to the CHRO role. Does this approach elevate CHROs to a higher status?

**Bryan Hancock:** The truly great CHROs would object to that statement. They'd say, "I elevated it 15 years ago." But for every five CHROs at that level, another 50 would say, "I've been elevated, and I'm invited to leadership meetings, and I participate on what talent is, and I run my HR budget by the CFO before I take it to the CEO." They think they're elevated, but they're not talking value. They're not saying, "If we're going to grow in China, we need a different person there, and we're going to accelerate this."

We work with forward-looking CHROs who might say, "I can raise \$10 million in EBITDA [earnings before interest, taxes, depreciation, and amortization] from sales by going after assessment." That's different from "I'm having the conversation we added to the performance review this year to talk about each person's individual value." But it's tricky, because the great CHROs bristle when you say "elevate the role."

# 'I'd love to see CHRO as a stepping stone to CEO.'

—Bryan Hancock

**Bill Schaninger:** When Dave Ulrich [Rensis Likert Collegiate Professor of Business Administration at the Stephen M. Ross School of Business, University of Michigan, and a partner at RBL, a consulting firm] first wrote about strategic HR, this idea of having a seat at the table, it was almost like you needed permission. If I were hoping for a mindset shift, I'd say, "Stop acting like the CHRO and start acting like an officer of the firm. You need to know how the place makes money. You need to know what's at risk."

**Bryan Hancock:** We held an event recently for 23 CHROs from PE-backed companies, plus several PE operating partners responsible for talent in the portfolio. That was the most amazing group of CHROs I've ever seen in a room together.

At a break, somebody came up and said, "One of your guys slipped and talked about operating income. All we care about is EBITDA." And the response was, "You're right. We'll fix that. Thank you." Or they'd say, "We're a rollup of these different companies. Here's how I think about talent that will drive value, and here's how we're going to do it." It was a different conversation about delivering value. And it was remarkable compared with other rooms of CHROs, where maybe two or three think that way.

**Lucia Rahilly:** Do you attribute the richness of that discussion to a change over time, or to the fact that these CHROs were in private equity?

**Bryan Hancock:** It has definitely shifted over the past decade. I think PE firms recognize that it's harder and harder to get a deal that's not fairly

priced on the front end, so they're adding value by making the place better. They've ruthlessly identified the levers that make it better. Talent is among the most consistent of those levers, and so now operating partners focus on it, which wasn't the case ten years ago. CHROs are being asked about it, being driven into it in a way they haven't thought about.

And as PE firms start to see more and more returns from talent, I think it'll pick up outside. Over the next ten years, I'm hopeful that the same kind of shift will happen.

**Lucia Rahilly:** What was the percentage of women CHROs in that room?

**Bryan Hancock:** Majority women.

**Bill Schaninger:** Let's just be careful not to confuse diversity and inclusiveness with "the female slot in the C-suite." Not that having a concentration of female talent in HR is bad. It just risks becoming where we put highly qualified, talented women.

Imprinting happens when kids are in school. That already changes the funnel—what school they go to, their degrees, whether they go to grad school. We're already messing with 52 percent of the population. Then, at work, we have assigned roles: "Oh, you're good with people: HR."

If we're committed to developing multitooled, multifaceted leaders, how about if everybody takes a tour through the company? Figure out how we

make money, how we make stuff, how we buy stuff. Pay attention to our talent. We need to pick people based on their knowledge, skills, attributes, and experiences, not some preconceived nonsense.

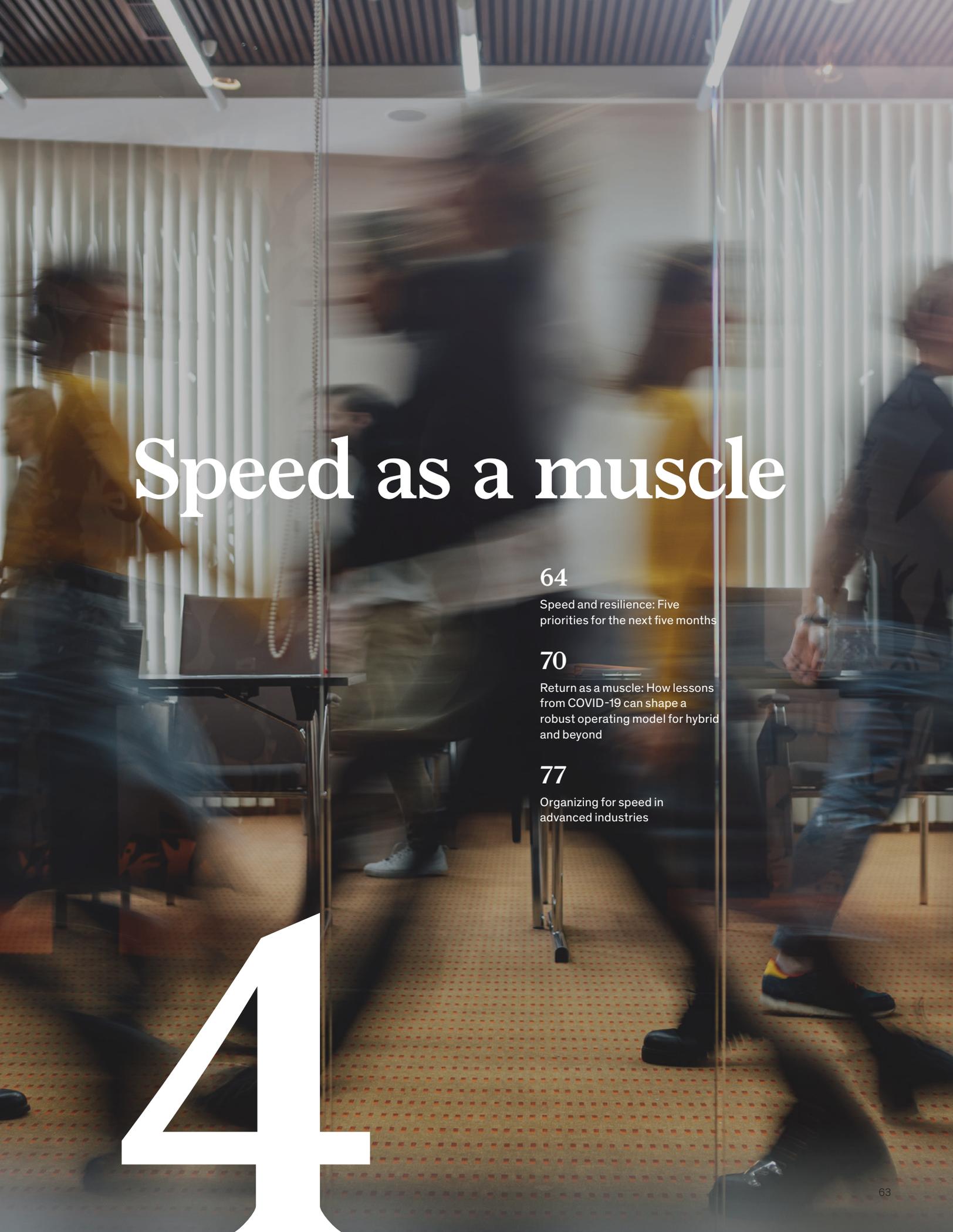
**Bryan Hancock:** I'd love to see CHRO as a stepping stone to CEO. If you're driving the value agenda through people, and you have a diversity of other experiences—maybe some operating experience, maybe some sales experience—and then you get to the CHRO role by talking about value, then you can

move from CHRO to CEO. I'd love to see more folks thinking that way.

Anecdotally, when I hear about CHRO searches, one of the things I hear more now than five years ago is, "This is on track for CEO." Not the majority of searches, but more than before. So I have hope that if we make this a value role, it should become a core source of talent for the next generation of women CEOs.

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# Speed as a muscle

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# Speed and resilience: Five priorities for the next five months

As businesses recover from COVID-19-related disruption and reimagine themselves for the next normal, they need to ask—and answer—five questions.

*by Mihir Mysore, Aditya Sanghvi, Navjot Singh, and Bob Sternfels*

**Speed has been** a fundamental characteristic of the COVID-19 pandemic—the virus hit fast, sending much of the world into lockdown just months after it was first detected. Businesses reacted rapidly, reorganizing supply chains, adopting remote-work models, and speeding up decision making with surprising velocity. Vaccines were created with unprecedented swiftness. And as with prior crises, the organizations that acted quickly to counter the COVID-19 downturn dealt with the disruption better than the organizations that reacted more slowly.

### **The need for sustainable speed**

Speed is also likely to be a central feature of what happens next—with one important difference. Over the past year, adrenaline unlocked speed. In the near future, speed will need to arrive by design.

For companies to achieve long-term resilience, it is imperative for them to ensure that the speed they successfully unlocked during the pandemic remains sustainable in the future. To do this, organizations will need to take into account not only potential strains on capacity but also the mental health of their workforce and the burnout often experienced by employees. To prepare, businesses need to ask and answer the following five questions.

#### **1. What kind of demand shift should we expect, and how do we get ready for it?**

Both business-to-consumer (B2C) and business-to-business (B2B) companies expect to see meaningful shifts in the shape of future demand. This will affect their commercial model.

During the COVID-19 pandemic, many households prioritized buying goods (especially basic products such as groceries) over services (such as restaurants and hair salons, many of which were closed anyway). As a result, pent-up demand could lead to a spike in spending on services as and when normalcy returns. What is still unclear is which services will return and in what form. For example, consumers have been spending more on home-based products, such as streaming and meal delivery. Will those preferences stick, or will consumers revert to their prepandemic habits? Or

something in between? How quickly will travel and related services recover, and what will consumers expect from these experiences?

Recent McKinsey research on prospects for consumer demand found that online grocery shopping, virtual healthcare visits, and home nesting were likely to stick. On the other hand, people would likely return to prepandemic patterns, or close to them, when it came to leisure air travel, live entertainment, and education. As for those consumer-products companies and retailers whose sales have risen during the pandemic, they will need to keep up with changing consumer demand to avoid a slump. Approaches to doing this vary but include promotions, more detailed segmentation, better customer experiences, and enhanced product availability.

During the pandemic, many companies have been able to develop a deeper understanding of customer behavior. Real-time and detailed consumer segmentation can replace broad-brush, less accurate survey-based understanding. These data can not only be used to make better, more specific longer-term bets on how demand for a particular product or service may evolve but can also open up a world of new possibilities on how businesses can adapt at the speed of culture. Marketing campaigns will likely need to be conceived, launched, and adjusted much faster than was the norm even a couple of years ago.

Many B2B companies value the traditional sales model, and that new-relationship formation will continue to occur in person. There is research that supports the view that developing trust with B2B customers is tougher in entirely remote environments. However, there is also compelling evidence that B2B buyers prefer the convenience of online, or even automated sales, once trust has been established. An effective way to continue the relationship, then, is to ensure access to convenient online sales channels to drive speed and convenience for a new generation of B2B purchasers.

# Employers have a unique societal role to play in vaccination; they are important voices and can help reduce the friction associated with getting the vaccine.

## 2. How do we incorporate new ways of working to enhance productivity and health?

Over the past year, organizations have become well versed in the basics of ensuring a safe working environment. More recently, however, companies have reported that some of their workers appear to be more willing to participate in higher-risk activities simply because they are tired of living with virus restrictions. This will require a different type of intervention and messaging, especially because newer COVID-19 variants pose a high risk and may be transmitted in ways that are not yet fully understood. Employers have a unique societal role to play in vaccination; they are important voices and can help reduce the friction associated with getting the vaccine.

Self-reported data from a wide range of organizations point to individual and team productivity being higher than before the onset of the pandemic, but not uniformly so. According to a McKinsey survey, productivity is up for about half of all workers, with the other half reporting no change or lower productivity. The same survey suggested that, while the inability to disconnect is a real concern, increased productivity is correlated to a willingness to change *how* people work. For instance, 67 percent of the organizations that reported higher productivity also reported a significant increase in work getting done through multiple, quick meetings, typically lasting less than 15 minutes or resolved through an exchange of text messages. Evidence is also emerging that appears

to show a correlation between an employee's sense of belonging and higher productivity. An unpublished McKinsey survey of employees found that companies that managed to build inclusiveness into the remote-work arrangements that resulted from the COVID-19 pandemic were significantly more likely to see increased productivity.

The shift to virtual work has also resulted in a wealth of new data about how work is done. Meetings are more likely to take place via videoconferencing. Communication is more likely to occur through electronic channels or remote-meeting applications. Such data, interpreted correctly, can pinpoint opportunities for skill building at a higher frequency and specificity. For example, the chief human-resources office of a leading consumer-products company is rewriting her job description because she believes the role will need to evolve into one in which data science and interpretation take on greater prominence. This kind of role adaptation, as well as the ability to construct, schedule, and deliver remote courses with far greater ease and efficiency than in-person training, means that the promise of specific, real-time upskilling is closer than before.

In some cases, companies are using this moment to strengthen their speed muscles, while also increasing the emphasis on building personal connections and reducing fatigue. Work can and should look different to create competitive advantage in performance and health.

### **3. How do we get the most value out of office real estate?**

When the COVID-19 pandemic hit, many workers abruptly began to work from home. At first, the thinking was that productivity and job satisfaction would plummet. In fact, while some people struggled with the transition, for others, the new arrangement showed how much flexibility one can have in how—and where—to work. As a result, the workplace will never be the same.

At the same time, however, the level of remote-work adoption that has occurred in the context of COVID-19 is unlikely to persist into the future. We believe that the future for knowledge-based companies will be hybrid. Bringing people together in person can enhance collaboration, ensure alignment, and foster community. Companies will need to decide when to require a physical presence and how often such in-person meetings should take place.

This is not a simple undertaking. The moments that matter vary by roles and processes. Organizations need to accept that they may not get it right the first time and should treat this as a continuous experiment in which they regularly measure productivity, collaboration, innovation, and community. In short, companies need to understand both what is working (and scale it) and what is not working (and change it).

Organizations need to accelerate building a real capability around the right way to do hybrid work, especially as more work returns to the workplace. This process is unlikely to stop even when functional herd immunity is achieved. Implemented correctly, the hybrid-working model brings a real competitive advantage because employees will have the flexibility that enables them to be more productive while still feeling that they belong to an energizing community.

Leaders will need to make decisions about office real estate, namely: What kind of office footprint will

the organization have (how much space is needed), and what will the working experience be like inside—and outside—that footprint (how will people work)? Footprint needs depend on the average size of the group required to foster meaningful interactions. For instance, if the vast majority of a company's interactions are in smaller groups or teams, the company could consider shifting offices to a greater number of small locations, rather than being anchored to a few large hubs.

When it comes to the experience, businesses will need to create a seamless model that makes it possible to work from anywhere—whether from a company office, home, coworking stations, or other venues. They will also need to adapt their physical spaces to focus on social and collaborative interactions rather than on providing spaces for individual work. As the post-COVID-19 era evolves, workers may expect companies to provide a more appealing office experience, which may require new thinking on digital experiences, amenities, and other aspects of working life. Organizations will need to analyze how they use space and how to repurpose the space they have to get the most value. They may also want to push for more flexible leases; ideally, landlords will become solution providers that work with companies as they reimagine their space.

Finally, in the coming weeks and months, companies will need to get relentlessly practical about the return to work, going far beyond platitudes about hybrid work and flexibility. They will need to define clear guidelines, for instance, about when they expect people to show up in person for the moments that matter. They will need to define which decisions will be taken by top managers and what latitude team managers will have to decide the extent of their in-person work. Site-based pilots, where practicalities such as meeting-room bookings, cross-silo team collaboration, and space requirements, will be critical to minimizing friction as people start to return in larger numbers.

#### **4. How can we reimagine capital allocation to promote resilience?**

Capital allocation used to be primarily about making large bets early based on a distinctive knowledge of trends that could take years to play out. During 2020, a year of extreme uncertainty, it became clear that this view needs to be complemented by a new way of thinking. Specifically, companies need to develop a capital-allocation process that allows them to create value by navigating fast-moving disruptions that can manifest themselves over days or weeks, as opposed to years.

In 2018, McKinsey analyzed the performance of 1,100 companies during the 2008–09 recession and identified those that did especially well (“the resilient”). The resilient did not lead their sectors in any special way before the recession occurred, but they moved faster than their peers to maintain earnings before interest, taxes, depreciation, and amortization (EBITDA) at slightly higher levels by the time of the trough, an advantage they then sustained. Indeed, they grew EBITDA quarter after quarter, allowing them to invest more than their peers and create significantly greater value. Ten years after the recession, 75 percent of the resilient were still outperformers. The conclusion: their performance during the disruption helped them

create a competitive advantage that was very tough for others to claw back when growth resumed.

In 2020, McKinsey repeated this analysis with more than 1,500 companies, and the findings were similar: a small group of companies were successfully navigating the pandemic-related business disruption to create value. Interestingly, the research found that the companies that managed to invest their capital in a balanced way—across growth, margin, and optionality—did better than those that focused only on a single dimension, such as growth or cost cutting.

Navigating business disruption deftly is easier said than done. One critical capability is “trigger-based capital allocation.” This involves defining a set of big moves, such as M&A, portfolio reallocation, or divestitures, that could significantly alter the shape of the business. Then, the company defines specific conditions, or triggers, under which it would take the proposed action. Finally, the company needs to have a clear mechanism for identifying whether these conditions have occurred—and it has to be able to move quickly when they do. To make trigger-based allocation work, top leaders need to agree on the goals related to capital allocation, and they need to set up a monitoring mechanism so that they are ready to act.

**Organizations need to accelerate building a real capability around the right way to do hybrid work, especially as more work returns to the workplace.**

## 5. What broader role should organizations play in their communities?

The COVID-19 pandemic has been a global humanitarian challenge. It is right, then, that companies take stock and consider their responsibilities—not only to their shareholders but also to their employees and the societies where they operate.

In the United States, for example, COVID-19 has disproportionately affected women, minorities, people of color, lower-income workers, and small businesses. Students have also been widely hurt as schools and colleges largely shifted to remote learning.

Businesses have a role to play in rebuilding robust economies and in improving their communities. As a part of their corporate social-responsibility efforts, companies should consider which areas to prioritize based on the strengths of their organization and on what their people value most. Efforts can be small, such as ordering takeout from local restaurants to help support small businesses. They can be in the form of services, such as counseling small-business owners on how to adapt in the COVID-19 era. They can be more systematic, such as directing

job creation and recruitment to those in hard-hit cohorts or investing in training to equip new graduates to find jobs or help vulnerable workers gain new skills so they can evolve in their current role or change careers. In any case, leadership needs to take an active role.

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In June 2020, McKinsey asserted, “An organization designed for speed will see powerful outcomes, including greater customer responsiveness, enhanced capabilities, and better performance in terms of cost efficiency, revenues, and return on capital. The speedy company might also find it has a higher sense of purpose and improved organizational health. These outcomes are possible, but not inevitable.”

Nine months later, we think that this analysis is as sound as ever. Speed matters, but not at the cost of making mistakes or burning out. By asking the right questions, business leaders can improve the odds of negotiating the next normal successfully, and in so doing, help themselves, their employees, and their communities.

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Illustration by Edu Fuentes

# Return as a muscle: How lessons from COVID-19 can shape a robust operating model for hybrid and beyond

New research shows how resilient organizations thrived through the pandemic. Here's how to use those lessons to craft a better approach to how work gets done across time (real and asynchronous) and space (digital and physical).

*by Aaron De Smet, Mihir Mysore, Angelika Reich, and Bob Sternfels*

**In May 2020**, we published an article arguing that the return to the workplace was a new muscle that organizations needed to develop, not a plan with a predictable timeline. The need for organizations to build this muscle is especially urgent today as vaccination levels around the world rise, infection and hospitalization levels in many countries decrease, and companies begin their return from remote.

Many companies are already in various stages of a physical return to the workplace. In the United States, for example, employees are starting to return to office locations at a greater pace. Consumer and retail footfall to headquarters has increased by 80 percent, travel and logistics are up 50 percent, and pharmaceutical and healthcare are up 10 percent.

A few short months ago, it wasn't clear that business leaders would so fully embrace a return to the office. But it's now evident that they will. Some 52 percent of C-suite executives we surveyed espouse an almost full return to the office, with workers on-site four days per week or more. Nine out of ten think that employees will be in the office at least three days per week.

Company leaders have good reasons for wanting workers back in the office. As the pandemic dragged on, people's sense of belonging and social connections suffered, especially among newer employees. Interactions across silos became increasingly difficult via remote. Many women left the workforce, widening the gender gap. Mental-health issues, grief, anxiety, and burnout are on the rise, reflecting a decline in the informal and intimate human connections that often occur at the workplace.

Reversing these trends is critical. But leaders are coming to realize that a physical return to the office is no panacea.

In spite of the difficulties employees encountered during remote work, they enjoyed the flexibility and convenience and are reluctant to go back to prepandemic working norms. More than 40 percent fear they will disengage from work if faced with a full return to the office, and a healthy portion is prepared to leave. An office-heavy return may also set back corporate diversity, equity, and inclusion

goals that leaders have pushed for years. More women could leave the workplace if they lose flexibility, while diverse employees and parents with young children are more worried than others that a full return will have a negative impact on their mental health.

Leaders themselves are also starting to worry about a potential dip in performance. Won't collaboration be more difficult, not less, when some people are on phones, others are on videoconference, and still others are in the office? Will getting it right mean investing in all kinds of new and expensive technologies? Couldn't time spent commuting every day be used more productively?

The more they explore the details of this return from remote, the more they acknowledge its complexity. This article aims to clarify the process. First, we'll consider research conducted with more than 500 senior executives across eight industries that offers valuable lessons pointing to key actions leaders must take during the return from remote. Then we'll look at the five muscles companies must build if they are going to seize this moment to create a robust and productive operating model for the future.

## **Four lessons from the last year of virtual work**

During the pandemic, about 50 percent of the companies in our research data set increased performance, while the rest saw no meaningful change or decreases. These numbers remained true whether we measured decision speed and quality, individual productivity, team productivity, or other performance metrics. The top performers also had lower variability, meaning that they were more likely to see performance gains across the board and not just for some teams. The most productive even witnessed a 48 percent increase in employees' job satisfaction, versus a decrease of 9 percent at the worst-performing organizations.

We call those companies that improved performance the "Organizational Resilients" and those that didn't the "Non-Resilients." So what can we learn from the Organizational Resilients?

The overall message is that Organizational Resilients doubled down on actions that many top companies

had already started executing before the pandemic as part of the movement toward more agile, more people-focused operating models. During the pandemic, more companies turned to these ways of working out of necessity—they had to get nimble to withstand innumerable unexpected challenges. Going forward, successful companies are sure to double down on this trend yet again. The four key lessons identified by our research can inform the actions of every organization returning from remote.

**1. The leaders of Organizational Resilients invested disproportionately more time crafting clear goals and clarifying strategy for their organizations**

During the pandemic, business leaders made a huge effort to give the clearest guidance possible, whether laying out strategic imperatives or painstakingly breaking down problems they wanted teams to solve. At Organizational Resilients, leaders increased their investment in delivering such clarity by nearly 80 percent. Leaders of Non-Resilients also increased their efforts, but only half as much.

This resonates with McKinsey research on decision making, which found that crafting clear goals and clarifying strategy was one of three “must do’s” to drive better and faster decisions across teams. The reason leaders often feel they need to intervene in and micromanage decisions is that when these get delegated down to the appropriate level, the lower-level employees who are empowered to decide often

are too siloed and have individual accountabilities that are too tactical. Without sufficient clarity from leaders on broad enterprise goals and strategies, those at lower levels who would otherwise be capable of making good decisions make bad ones.

**2. At Organizational Resilients, small, cross-silo teams focused on outcomes and were empowered to make decisions that drive impact**

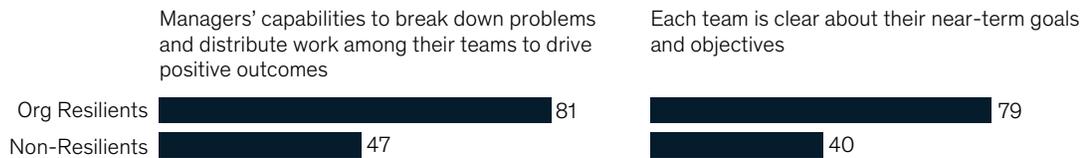
During the pandemic, Organizational Resilients increased their reliance on networks of small, empowered, cross-silo teams by 61 percent (versus 29 percent for Non-Resilients). They also invested in team cohesion by increasing the quality and quantity of team-building events. They increased delegation and supported this shift in management style by investing more frequently in leadership training for team leaders.

Their teams focused specifically on outcomes, not process. Organizational Resilients leaned into the meaningful trend from input-based management (Are people busy? How active are they?) to outcome-based management, where the teams focus on achieving a single outcome by whatever means they deem best. This trend is here to stay. It’s a key element of the future of work. Strong companies will increasingly emphasize cross-silo teaming and collaborating. They will change expectations and working models for managers at as high a rate as is needed. And they will invest in the development and success of networks of these teams.

Exhibit 1

**Organizational Resilients’ leaders disproportionately invested more time crafting clear goals and clarifying strategy for the organization.**

**Share of C-suite executives of companies with revenue >\$1 billion who reported increase, % of responses by group (n = 504)**

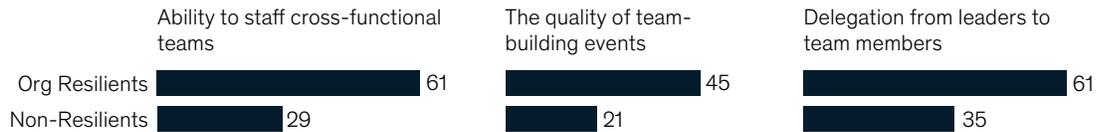


Source: McKinsey 2021 Remote Work CXO Survey

Exhibit 2

**Organizational Resilients staffed cross-silo teams that were focused on outcomes and empowered to make decisions that drive impact.**

Share of C-suite executives of companies with revenue >\$1 billion who reported increase, % of responses by group (n = 540)



Source: McKinsey 2021 Remote Work CXO Survey

**3. Organizational Resilients’ leaders spent more time on coaching and recognition**

Almost half of Organizational Resilients increased their investment in coaching, and 60 percent gave more recognition to employees. Most Non-Resilients did not increase their investment at all. Top performers moved senior executives into goal-setting, decision-making, and coaching roles to speed decision making, a shift that will be as critical to the return from remote as it was during the pandemic. Microinteractions (meetings that lasted less than 15 minutes and resulted in a clear action or decision) went up by 73 percent for Organizational Resilients—more than twice the increase at Non-Resilients.

Great companies know that successful delegation is far more than leaving people to their own devices. It’s very much a hands-on affair. Empowerment works when leaders set clear strategic direction and offer good coaching and meaningful recognition.

**4. Organizational Resilients were disproportionately more likely to absorb and adopt new collaboration technologies**

Speedily working new collaboration technologies into operations is an essential element of any company’s success. Nearly 60 percent of the executives we queried at Organizational Resilients believed that their organizations made collaboration technologies easy to adopt, versus just a quarter of Non-Resilients. And while fewer than 15 percent of Organizational Resilients felt that absorbing new technology was difficult, 30 percent of Non-Resilients reported challenges in this area.

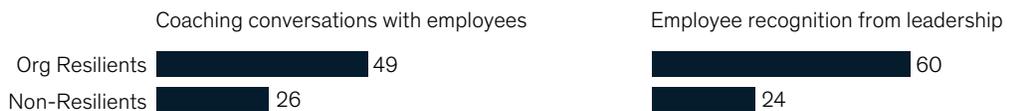
**The return muscle: Unlocking sustainable performance and health in a hybrid world**

Many of these lessons, such as the fact that hierarchical organizations stifle growth and slow decision making, are not new. Before the pandemic,

Exhibit 3

**Organizational Resilients’ leaders increased the time they spent on coaching and recognition.**

Share of C-suite executives of companies with revenue >\$1 billion who reported increase, % of responses by group (n = 540)



Source: McKinsey 2021 Remote Work C-suite executives Survey

Exhibit 4

## Organizational Resilients were disproportionately more likely to absorb and adopt new collaboration technologies within the organization.

Share of C-suite executives of companies with revenue >\$1 billion who reported increase, % of responses by group (n = 540)



Source: McKinsey 2021 Remote Work CXO Survey

however, many companies found it difficult to drive an operating-model reinvention when there were plenty of other competing priorities. The pandemic made clear that they were far more capable than they had imagined of significantly changing the way they work.

As we head back into the workplace, companies want to maintain these hard-won gains. Part of getting the return right is to build five muscles that strengthen the backbone of a new, more competitive operating model.

### Expand executive focus on strategic clarity, coaching, and empathy

As we mentioned above, Organizational Resilients are much better than others at coaching and at recognizing people for their achievements. Survey after survey shows that the leading driver of performance and productivity is not compensation or stretch goals but the sense of purpose employees have when they belong to a community whose values they share, that does good things in the world, and that recognizes their contributions. Leaders can build this muscle by being more intentional about in-person interactions.<sup>1</sup>

### Foster outcome-based management of small, cross-functional teams

When work moved from the fields and artisanal workshops to the factories during the Industrial Revolution, there was a division of labor, a standardization of work, and mechanization with

standard interchangeable parts. As workers went into factories and worked on assembly lines for others, supervisors watched to make sure that tasks were completed correctly. With time and motion studies, this became a science (à la Frederick Taylor's theory of scientific management). The result is that strict supervision and control of concrete, observable tasks and outputs has become inculcated into how we manage work.

The return from remote is a unique opportunity to put all that behind us, replaced by outcome-based management that is both more human and more effective. Leading companies have already started to do so, as witnessed by the success of Organizational Resilients.

Building this muscle means that performance-management practices designed for control must shift to practices designed to empower and enable teams and people. Examples include 360-degree feedback from teams, holding managers to account for clarity of goals and outcomes, having senior leaders spend real time on mentoring, and sometimes introducing objectives and key results that live alongside key performance indicators. The goal of all these practices is the same: focus employees on outcomes, not inputs.

### Increase talent velocity, especially with reskilling

The ability to staff teams across organizational silos is a core feature of agile models. Virtual work allowed companies to build teams of equals drawn

<sup>1</sup> For more, see Aaron De Smet, Bonnie Dowling, Mihir Mysore, and Angelika Reich, "It's time for leaders to get real about hybrid," *McKinsey Quarterly*, July 2021, McKinsey.com.

from across all time zones and geographies. It gave companies everywhere the chance to overcome regional talent gaps by tapping into the global talent pool. Employees could deploy to a new team simply by switching to a different video screen.

This kind of enhanced talent velocity was a key differentiator for Organizational Resilients and is likely to be a hallmark of winning organizations for years to come. Building this muscle can entail the development of internal-talent marketplaces or talent-redeployment hubs that make it easier for people to discover potential projects. It may also mean giving people the flexibility to move between projects without leaving their trusted networks. And, critically, it means increasing the rate at which people can be reskilled and upskilled, with both formal training and informal apprenticeship and mentoring.<sup>2</sup>

The impacts of automation and other new technologies make building the reskilling muscle an imperative. Automation is messy. Often, it's not whole jobs that are being fully automated but only the chunks that don't need the kind of significant value-added work that people do. When 50 percent of a job is automated, the way to capture that value is to evolve the work, creating new full-time roles that often require new skill sets.

In fact, automation may even drive a need for better social reskilling. As work that is modular, predictable, and routine gets automated, the work remaining for people is the opposite; it is dynamic, unpredictable, and more inherently human. This work calls for social and emotional skills, higher-order human judgment, creativity, spontaneity, and innovation. It tends to be purpose driven and anchored in human interactions. In other words, the most important and value-adding work for people to perform in the future will be dynamic, team-based, complex, and cross-functional.

### **Find new zero-cost, high-optionality ways to collaborate**

During the past year, many executives came to realize the true cost of collaboration as practiced

before the pandemic. A North American CEO told us that in the past, a single-day meeting with his leadership team in Asia had required him to invest the greater part of a week in travel time. But during the pandemic, he was able to meet with people across time zones, continents, and oceans at no cost and to better effect. He said his teams in Asia know him better now than ever. Sales teams reported that it was far easier to maintain existing relationships with people in remote settings—even though they acknowledged that in-person meetings are critical for developing new contacts.

Virtual work allows workforces to collaborate in a “costless” way. But the transaction cost of collaboration will rise when people start commuting and traveling again. This doesn't mean you should eliminate travel—far from it. Instead, organizations can build a muscle to increase the rate at which they discover and adopt better physical and digital modes of collaboration.

Leaders should define a model for doing this. Learning about these collaborative tools and using them well becomes a mandate for team leaders and executives. Physical workspaces may need to be reconfigured to better facilitate multiple modes of hybrid collaboration. To keep interaction costs low and productivity high, companies can build adequate optionality into their collaboration tool kits. Sometimes people need an informal, confidential channel for banter. At other times they need a whiteboard. They may also need guidelines on how to make hybrid meetings effective.

Five years ago, the vast majority of group interactions took place via email, conference calls, or in-person meetings. We now have many more options. Videoconferencing is common and more sophisticated, with virtual whiteboards, polling, brainstorming, and more. Large meetings often have virtual producers helping manage breakout groups, group voting, and interactive virtual exercises. Using chats, instant messaging, and other forms of synchronous and asynchronous information sharing and interaction is commonplace. To get the most out

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<sup>2</sup>For more, see Aaron De Smet, Gregor Jost, and Leigh Weiss, “Three keys to faster, better decisions,” *McKinsey Quarterly*, May 2019, McKinsey.com.

of these technologies, we need to be much more intentional about how we design interactions and how we communicate expectations and working norms.

### **Increase the rate of technology adoption**

Organizational Resilients adopted technology faster and more often than Non-Resilients. Now every company has to build this muscle. Seeking out new technology and using data as a way of getting to better outcomes and decisions must become a new norm.

When people learn a new thing (from driving a car to leading teams differently), they often find in the early days that it requires a lot of effort and attention, feels hard, and offers few rewards because they are not good at it yet. That's why technology adoption is not only about deployment. It is also about learning to use that technology, becoming adept at applying it, and leveraging it in new ways that enhance effectiveness and efficiency. This puts a premium on creating a learning organization that adapts as technology capabilities evolve.

The past year was full of examples of such adaptation. Supply-chain teams developed apps to increase

transparency into the system, using long-available but never-mined data. The engineering division of an oil and gas firm decided to start every project kickoff by creating a dashboard to track progress against outcomes. By the time the kickoff was over, the dashboards were live and the data was piped in.

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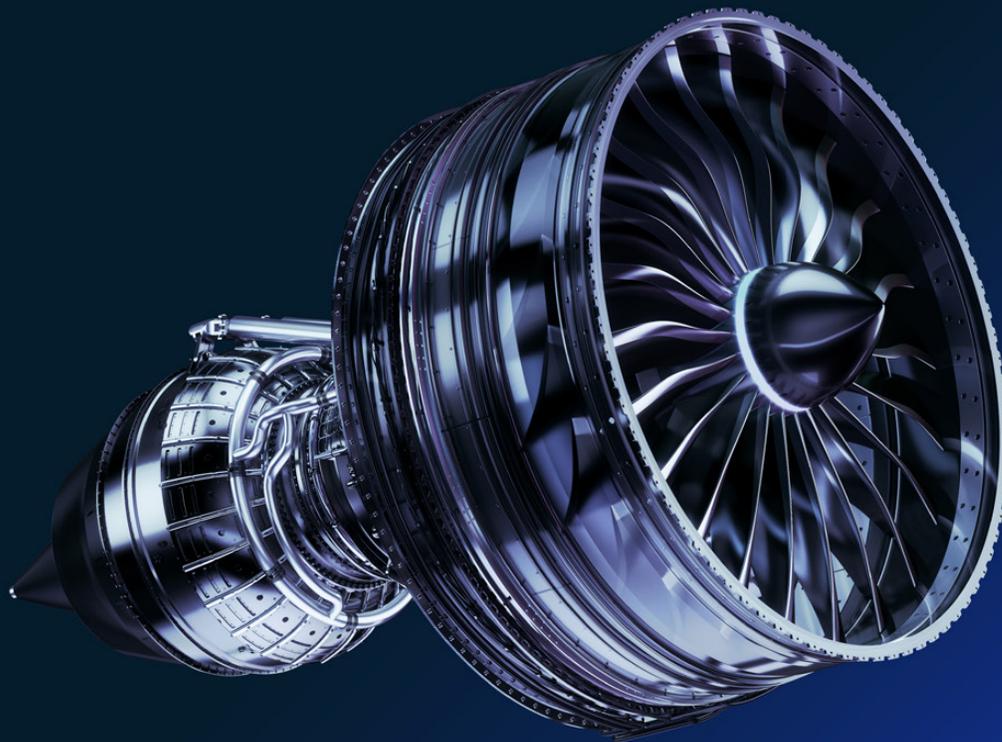
The return from remote is ripe with potential for a productive reimagining of the way work gets done. But going back to the office isn't a silver bullet. During the pandemic, Organizational Resilients excelled by communicating clearly, leaning on cross-silo teams focused on outcomes instead of inputs, coaching well and recognizing employee wins, and speedily adopting new collaboration technologies. These are the kinds of qualities that will fuel tomorrow's productivity powerhouses.

Building the muscles needed to drive this kind of success will take time, at the very moment when leaders are faced with a damaged, needy workforce. It's a challenge that will call on every bit of patience and empathy that leaders can muster. It's also a challenge that may well define the future of work.

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The authors wish to thank Bonnie Dowling and Raphael Ruscassie for their contributions to this article.

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# Organizing for speed in advanced industries

Faced with the COVID-19 crisis, companies in advanced industries have become more nimble and have accelerated decision making. How can they retain this speed once the pandemic abates?

*by Elizabeth Mygatt, Asutosh Padhi, Charlotte Relyea, and Brooke Weddle*

**In almost every conceivable dimension**, the COVID-19 crisis is fundamentally challenging companies' assumptions about how they do business. The scale of the pandemic's impact and the uncertainty about its future course and consequences are forcing changes in organizational structure, decision-making processes, technology, and operations, from manufacturing to sales and marketing.

As discussed in an earlier article, many companies have already undertaken major shifts in these areas.<sup>1</sup> They have reconsidered ways of working, organizational structures, and talent. The common factor in these changes has been increased operational and decision-making speed in an unprecedentedly dynamic environment. And it is already clear that this requirement is here to stay. The question facing companies in all sectors is how to move from adrenaline-based speed to speed by design—in other words, how to build increased speed into their operations on a permanent basis.

In McKinsey's recent Global Leadership Survey on organizational speed, which included about 900 senior executives from nine industries, respondents revealed that they were already focused on the need for speed. A large majority, including leaders from advanced industries,<sup>2</sup> expect major change in almost every facet of their organizations as a result of the COVID-19 crisis. Fundamental and lasting shifts are predicted in everything from the structure of meetings to the role of leadership, and from core processes and technology to talent, skills, and organizational culture. "Purpose" is one of the only areas where less than 20 percent of respondents anticipate meaningful change.

Respondents from companies in advanced industries, like those in other sectors, already report significant successes in boosting efficiency, effectiveness, and speed during the crisis. Another survey finding, however, should be of concern: while executives in advanced industries agree that

lasting and broad-based change is coming, they are markedly less optimistic than their peers in other industries about their organizations' ability to sustain performance improvements in a post-COVID-19 world. This article investigates the perceived obstacles ahead and suggests ways to address them.

## Acceleration in the face of crisis

Speed is not, of course, an unfamiliar concept in advanced industries. In normal times, a fast-paced operating model helps companies in this sector manage the broad ecosystem of interdependencies across their supply chains in the face of disruption and the rapid innovation and digital transformation required by changing sector dynamics.

In the same spirit, advanced-industries organizations have adapted their operating models to meet the challenges presented by the coronavirus pandemic. They have increased the speed of decision making and have implemented radical changes in work practices and rapid transformational investments that have allowed many companies to maintain productivity and meet customer expectations. Consider a few success stories:

- ***Multiplying productivity.*** A major industrial factory ran at more than 90 percent capacity with only about 40 percent of the typical workforce.
- ***Turbocharging improvements.*** A US industrial player drove a lean-manufacturing program with 90 percent of its support employees working remotely. It accelerated progress on maturing frontline initiatives to achieve 30 percent greater productivity and quality.
- ***Developing new products.*** A major engineering company in aerospace and defense designed and manufactured ventilators within a week.

<sup>1</sup> Aaron De Smet, Daniel Pachthod, Charlotte Relyea, and Bob Sternfels, "Ready, set, go: Reinventing the organization for speed in the post-COVID-19 era," June 26, 2020, McKinsey.com.

<sup>2</sup> Advanced industries include automotive and assembly, aerospace and defense, advanced electronics, building technology, semiconductors, shipbuilding, and machinery.

# As advanced-industries companies try to make organizational speed a permanent part of their culture, they may encounter more obstacles.

- *Going remote.* A US defense contractor shifted two-thirds of its workforce to remote work. This required significant process innovation given its need to support sensitive customer missions.
- *Shifting operations.* A major shipbuilder switched from three to two shifts for thousands of employees, coordinating directly with local officials.

Survey respondents report myriad larger and smaller efficiency improvements, including big supply-chain changes, reductions in business travel time, better technology use to speed up meetings, streamlined electronic-approval processes, and a shift from in-person to online marketing.

Many respondents mentioned the benefits of greater remote and online working. One said remote working “ushered in a new paradigm where the best experts from anywhere in the world can easily offer perspectives on how to resolve complex production problems.”

Another reported that remote work, coupled with time made available by production slowdowns, enabled engineers to “meet their mechanics” and deepen their understanding of practical issues in handling parts.

“Meeting online to make decisions, which still puts people face to face, had a massive impact on our ability to quickly move forward and implement with the working teams,” wrote one executive from a

firm operating on a far-off campus, where meetings previously required travel between buildings.

“Approvals for projects that yield significant benefits are being fast-tracked,” said another. The result: normal approval lead times fell by 50 percent.

A respondent at one company described moving testing and design processes online, using remotely accessed data, computer-aided design (CAD) and computer-aided management (CAM), and design-review programs. The company also used online tools to review plant operations, rather than making in-person visits.

Others reported organizational and structural changes. “During COVID-19, we chose to integrate three business units/legal entities into one,” said one respondent. “This was done completely virtually . . . This integration allowed our customers to deal with one business unit, regardless of brand, streamline warehousing procedures, and unite the accounting platform. The immediate result is a 15 percent increase in speed to fulfill spare-parts orders and onsite requests for assistance.”

While these results are impressive, they occurred during a time of crisis. Companies knew that they had to move quickly and decisively in response to the COVID-19 crisis, and they did not hesitate to make changes. It was something of an adrenaline-based response. As advanced-industries companies try to make organizational speed a permanent part of their culture, they may encounter more obstacles, and they need to build the muscle to sustain this bias to action.

## Challenges to achieving speed by design within advanced industries

If companies can maintain the improvements prompted by the COVID-19 crisis—flatter hierarchies, faster decision making, nimble teamwork, and a new approach to learning and talent development—they could achieve significant benefits. Our research suggests that companies that successfully create a faster operating model tend to be more profitable, have stronger innovation outcomes, and experience greater growth.

With this in mind, advanced-industries companies should strive to make recent changes permanent. Our survey suggested, however, that they struggle

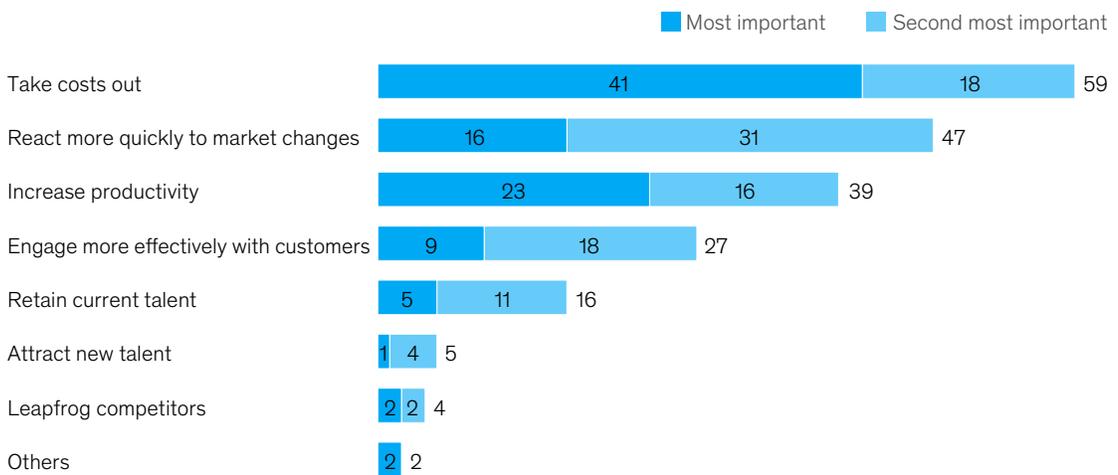
more with implementation than their peers in other sectors. There is a notable mismatch between executives' expectations of change and their beliefs in their companies' ability to make that change.

At a macro level, more than 70 percent of executives in advanced industries who responded either agreed or strongly agreed that their companies would see large-scale changes in ways of working, leadership, technology and systems, and core processes (Exhibit 1). The principal drivers of this change in advanced industries were the need to reduce costs (59 percent), to increase speed of reaction to changes in the marketplace (47 percent), and to increase productivity (39 percent).

Exhibit 1

## Many different drivers are prompting companies in advanced industries to make changes in light of COVID-19.

Most important drivers of changes made in response to COVID-19, %<sup>1</sup>(n = 97)



<sup>1</sup>Question: "When you reflect on what has driven any changes you have made in light of COVID-19, please rank the 3 most important drivers of those changes."  
Source: McKinsey Org4Speed Leadership Survey, July 2020 (n = 853)

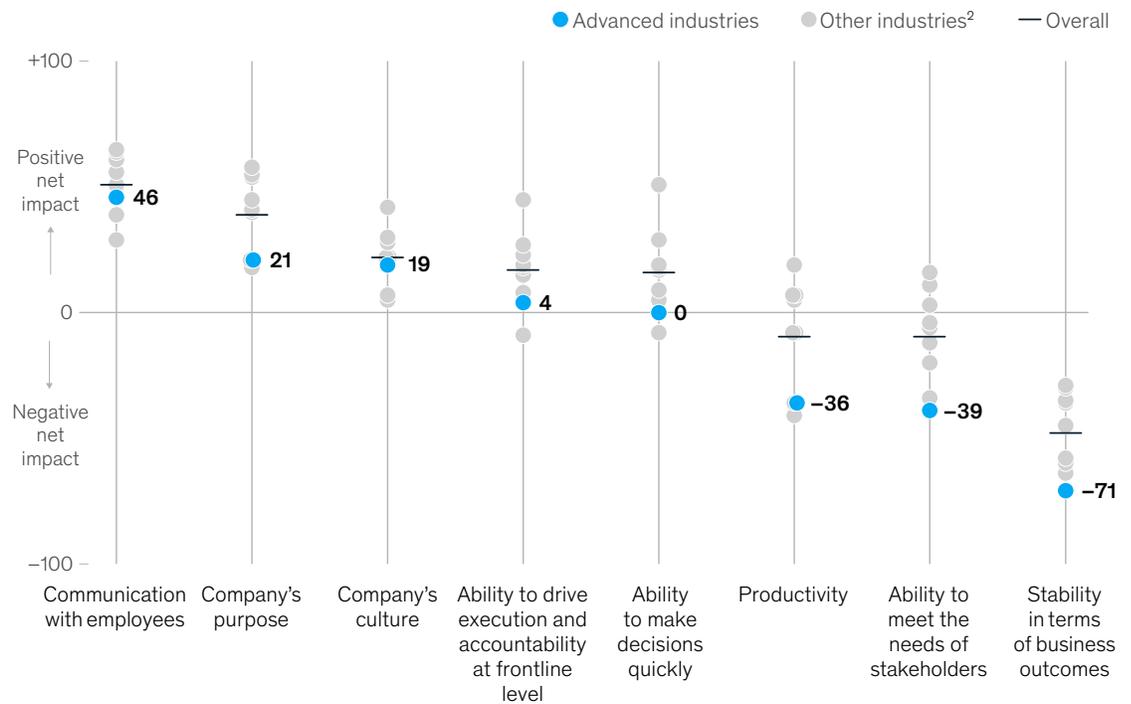
Across sectors, respondents noted that the COVID-19 crisis had already led to significant changes in operations, sales, supply chains, manufacturing, and human resources. Fully 71 percent of advanced-industries respondents reported that the pandemic had already had a significant negative impact on the stability of business outcomes—a higher proportion than in any other sector (Exhibit 2).

Yet in assessing their own companies' performance relative to peers, these executives were less positive than those from other sectors. A higher percentage of executives in advanced industries believed their companies were underperforming other sectors on organizational resilience, profitability, speed, and digital development; similarly, a smaller percentage of executives in advanced industries thought their companies were outperforming peers in other sectors.

Exhibit 2

### COVID-19 has had a significant impact on business—and leaders in advanced industries believe that it has had a negative impact in many areas.

Impact of COVID-19 crisis on selected aspects of business, %<sup>1</sup>



<sup>1</sup>Question: "What impact has the COVID-19 crisis had on each of the following?"

<sup>2</sup>Includes banking; consumer; global energy and materials; healthcare; insurance; pharma; technology, media, and telecommunications; and travel, transport, and logistics.

Source: McKinsey Org4Speed Leadership Survey, July 2020 (n = 853)

Questioned about perceived obstacles to operating at greater speed, executives in advanced industries cited organizational silos, slow decision making, and a lack of strategic clarity. Further, 31 percent of advanced-industries respondents reported problems with formal hierarchy—a much higher percentage compared with other sectors.

### Building speed

This analysis suggests that advanced-industries organizations have considerable work ahead if they want to make speed a permanent feature of their businesses. Key activities must include rethinking ways of working, reimagining organizational structures, and reshaping talent (Exhibit 3).<sup>3</sup>

Fortunately, survey results suggest that organizations are beginning to understand the type and scale of changes required. Consider a few examples:

- **Rethinking ways of working.** An aerospace company envisages a radically streamlined process to design, test, and install new passenger-facing features on aircraft, such as touchless boarding, self-cleaning surfaces, and redesigned security-screening procedures. Ideally, the path to adopting new features and processes will be measured in weeks or months. Another company suggests teleworking will become a cornerstone of its operations, with the aim of sharing expertise and spreading work around the globe and around the clock.
- **Reimagining structures.** Building on experience during the COVID-19 crisis, advanced-industries companies are significantly simplifying internal processes for project approval. One executive spoke of going from 30 handoffs to just three and reducing new-project cycle times from more than 20 weeks to five. Another was planning to institutionalize new forms of teamwork and collaboration between engineers and technical teams, with a focus on making parts easier to manufacture.

Exhibit 3

## Companies must focus on nine activities to increase organizational speed.



### Rethink ways of working

1. Speed up and delegate decision making
2. Step up execution excellence
3. Cultivate extraordinary partnerships



### Reimagine structure

4. Flatten the structure
5. Unleash nimble, empowered teams
6. Implement hybrid work successfully



### Reshape talent

7. Field tomorrow's leaders today
8. Learn how to learn
9. Rethink the role of CEOs and leaders

<sup>3</sup> Aaron De Smet, Daniel Pachthod, Charlotte Relyea, and Bob Sternfels, "Ready, set, go: Reinventing the organization for speed in the post-COVID-19 era."

- **Readapting talent.** Advanced-industries companies are unlocking hidden reserves of talent in their efforts to navigate the challenging COVID-19 business environment. One surveyed company said it was now drawing on talented leaders one or two layers below the head of business or function and redeploying them to focus entirely on planning and generating new scenarios every week. This is excellent training for more senior roles. Another advanced-industries company, with its attention drawn by the crisis to the risks of supply-chain instability, is redirecting its recruitment effort to hiring procurement experts who can help improve supply-chain management. This major change could add 10 percent to the company's workforce.

These are just a few examples of changes under way. But the scale of the challenges facing advanced-industries companies will require many more adjustments. Survey results suggest that companies in this sector will not succeed in building for speed unless their leaders take a hard and fundamental look at the way their organizations are constructed and managed at every level, starting at the top.

To get started, organizations can pursue a two-speed approach. They can make quick moves to lock in new changes that have generated positive outcomes, while simultaneously undertaking a broader evaluation of the structural and procedural foundations upon which the organization is built. This two-speed approach allows organizations to obtain some immediate gains while building the proper foundation for sustained speed going forward.

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Momentum is here (for now). Leaders see the art in what is possible, and employees have their eyes open to sustainable ways of working. The talent market is democratizing. Moreover, we know that in advanced industries, the market favors those who are able to innovate fast, make bold moves, and rapidly reallocate resources to lock in speed. We admire the incredible impact that advanced-industries companies have generated in such a short period of time and are optimistic about their potential to do more as they reimagine their work processes and organizational structures.

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More than a mission statement: How the 5Ps embed purpose to deliver value

Operate with  
purpose



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# The case for stakeholder capitalism

Consumers and society at large are expecting more from business. Embracing these responsibilities can help shareholders, too.

*by Vivian Hunt, Bruce Simpson, and Yuito Yamada*

**The free-market economy** is one of the most important reasons for the wealth creation and improved quality of life humanity has enjoyed in recent generations. In 1950, for example, Norway had the world's highest life expectancy (72.3 years). Now the global *average* is higher (72.6 years), and in Africa, where it is lowest, it is rising fastest. In China and India alone, more than 1.2 billion people have lifted themselves out of extreme poverty since their countries began to shift their economic policies toward more market-oriented principles.

None of this could have been done without economic growth. And that is what free-market-oriented economies, in their many different varieties, have delivered better than the alternatives. Think of West Germany versus East Germany; South Korea versus North Korea; or Costa Rica versus Cuba.

And yet, there is palpable anger and distrust with the idea of capitalism and the role of business in many societies.

One such indicator is increased political polarization in many countries, even in well-established democracies. Economic issues are often—and perhaps always—a source of such discontent. Another indicator is the most recent Edelman Trust Barometer.<sup>1</sup> Published in January, shortly before the COVID-19 pandemic changed the world, the

report includes a survey of 34,000 people, of which 56 percent believed that capitalism was doing more harm than good globally, with majorities in 22 of 28 markets surveyed.

As economic players, business people cannot stand offstage watching the action—and the same survey found that people don't want them to. Ninety-two percent of respondents said that companies should be speaking out on issues such as training, automation, and immigration, with 74 percent pointing to CEOs to take the lead. With the onset of COVID-19 and the wealth of information available, even those who would like to stay out of the action will find that, more and more, their employees and customers are demanding otherwise. The business ecosystem is evolving; those who resist will find themselves not only on the wrong side of history, but also at a competitive disadvantage.

### **An opportunity for positive change**

Business leaders should embrace the apparent contradiction—of low trust and high expectations—and make the choice to demonstrate that they see their mission as serving not only shareholders but also customers, suppliers, workers, and communities. The common term for this is “stakeholder capitalism,” and we think its time has come.

**The business ecosystem is evolving;  
those who resist will find themselves at  
a competitive disadvantage.**

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<sup>1</sup> “2020 Edelman Trust Barometer,” Daniel J. Edelman Holdings, January 19, 2020, edelman.com.

Many CEOs say they agree—at least theoretically. There are certainly examples of businesses just talking the talk and not following through. However, this is not a good idea for two reasons. First, many companies are making public commitments. Their progress, or lack thereof, can be tracked, measured, and followed-up on. Given the plethora of information available, even those who do not make such commitments can be named and shamed when their actions fall short of expectations.

Second, there is growing evidence that companies that take a long-term view—and stakeholder capitalism requires this—perform better. In a study that looked at 615 large- and mid-cap US publicly listed companies from 2001–15, the McKinsey Global Institute found that those with a long-term view outperformed the rest in earnings, revenue, investment, and job growth. Other McKinsey research concluded that companies with strong environmental, social, and governance norms recorded higher performance and credit ratings through five factors: top-line growth, lower costs, fewer legal and regulatory interventions, higher productivity, and optimized investment and asset utilization.

### Putting words into practice

So how can companies walk the talk? For more than a year, McKinsey has been asking that question of business leaders in a variety of sectors, as well as of activists, academics, and employees, and has been reviewing and conducting research.

We start from two premises: first, that serving all stakeholders is an ethical good that can also be a source of competitive advantage, and second, that to do this successfully, companies must be profitable. There is a term for an enlightened company with the most perfect intentions that does not make money: defunct.

On that basis, we have identified five principles for businesses to make stakeholder engagement a reality.

### Principle 1: Get the board on board

Experience can be a tough teacher but an effective one. Companies have learned the hard way that installing a chief innovation office doesn't mean that great ideas will start flowing, nor that hiring a chief digital officer will wake up the C-suite from its analog slumber. For stakeholder engagement to become real, commitment needs to start from the top—that is, the board. Boards are responsible for the long-term interest of the company; it is their role to define the company's mission and purpose. It's easy for CEOs to make soothing pledges; however, in the absence of support from the board, nothing will change, as it is the board that sets and governs strategy.

In this regard, there are two distinct but complementary approaches to consider. One is to appoint new board members with a diversity of experience, skills, and interests who can reflect the concerns and priorities of a wider range of stakeholders, rather than shareholders alone. That might mean inviting in nonprofit leaders, local government officials, or consumer groups to the table. An educational charity has done exactly this and seen impressive stability over the past 15 years. That is essential for the group to serve its purpose—and also for businesses that want to take a longer-term view.

The other approach is to change corporate governance guidelines to clearly assert stakeholder, rather than shareholder, priority. We know that in some jurisdictions, this may not be legally possible.<sup>2</sup> In places where it is possible, however, there can be no stronger signal because without it, it is fair to question the depth of a company's convictions.

Anglian Water Services is a UK-based company that supplies water to 2.5 million households. In 2019, it became the first utility company to embed public interest at its core. Independent directors, together with their investors, rewrote the British utility's Articles of Association, which governs how the business is run. The legally binding document now states that the company's purpose is "to conduct its business and operations for the benefit of members as a whole while delivering long-term value for

<sup>2</sup> "Was the Business Roundtable statement mostly for show?—Disregard of legal constraints," Harvard Law School Forum on Corporate Governance, August 19, 2020, [corpgov.law.harvard.edu](https://corpgov.law.harvard.edu).

# Companies with a stakeholder ethos should commit to putting principles into practice by publishing concrete, achievable, and measurable goals.

its customers, the region, and the communities it serves and seeking positive outcomes for the environment and society.” A director is explicitly required to act “in the way he or she considers, in good faith, would be most likely to promote the purpose of the company.” The company is bringing in independent evaluators to measure to what extent it is living up to its principles, and it has also set out five specific, measurable goals to reach by 2030, including leak reduction, affordability, and net-zero emissions.

Of course, changing corporate governance guidelines is no easy task. As an interim step, it should at least be possible for boards to institute “listening sessions” to hear from employees, community leaders, and outside experts.

## **Principle 2: Set and track environmental goals**

A core principle of business is that what gets measured, gets managed. Companies with a stakeholder ethos should commit to putting their principles into practice by publishing concrete, achievable, and measurable goals. This approach is particularly apt in relation to the environment, where there are clear and readily measurable metrics to track; factors such as “community engagement” may be important but are also less empirical.

So far, the record shows that in many cases, companies that have made environmental sustainability a priority have found that it is also good for the bottom line, since it can reduce

energy costs, for example, or cut the cost of packaging. Improving environmental performance is a marathon; it requires training and commitment. Publishing specific targets is a way for companies to show that they are committed to putting in the miles.

While the conventional oil and gas industry is not particularly well regarded by many green groups, a number of major companies show how setting and tracking environmental goals can be done. At bp, the publicly stated ambition is to be a net-zero-emissions company by 2050 or sooner. It has set out ten specific carbon aims, with incentives for employees to reach them. There are intermediate targets to watch, such as installing methane measurement tools at all sites by 2023, and bp regularly publishes its data.

Shell, the Anglo-Dutch oil company, has the same “net-zero emissions by 2050” goal. To get there, it is doing things like using flying drones to spot methane emissions, buying offsets, using solar power at lubricants plants, and investing in carbon capture and storage. Shell tracks a wide variety of metrics, ranging from spills and leaks to flaring and safety events, and it reports on its progress every year. Bonuses are linked to greenhouse-gas-emissions improvements.

Such efforts are not unique to Western firms. Nigeria’s Seplat, a small independent oil and natural gas company listed on the London and Nigerian stock exchanges, operates in the

environmentally sensitive Niger Delta. Since 2015, it has sharply lowered its use of fresh water, and since 2011, it has reduced the incidence of spills by 80 percent and has recorded lower rates of flaring and accidents—even as it cut operating expenses and increased production.

In an example from an entirely different industry, consider Brazil's Natura &Co, the fourth-largest cosmetics group in the world. Founded in 1969, its brands include Aesop, Avon, Natura, and The Body Shop, and it has become a global corporate environmental leader. An early adopter of the "triple bottom line"—publishing results on social and environmental metrics as well as financial ones—it has been carbon neutral since 2007. In 2010, Natura introduced refill packaging made of sugarcane ethanol. In 2014, it became the first South American public company, and one of the largest in the world, to be certified as a B (for "benefit") Corporation; certified companies are "legally required to consider the impact of their decisions on their workers, customers, suppliers, community, and the environment." (Aesop is also a B Corp.) And earlier this year, it pledged to reach net-zero carbon emissions by 2030. Customers have responded to its efforts, with revenues growing an average of almost 12 percent a year from 2009–19.

Finally, Ørsted is Denmark's largest energy provider. In 2008, when it was known as DONG Energy, coal was the source of 85 percent of its power. To illustrate how it can make good business sense to get ahead of social and regulatory trends, the next year, Ørsted introduced a ten-year plan to transform the company so that it would be 85 percent renewable by 2019. Year by year, company reports showed how the balance between coal and renewables was shifting, and it completed the plan a year ahead of schedule. Its new goal is to reduce emissions 98 percent from 2006 levels by 2025. The shift has generated positive returns: from 2009–19, revenues rose by 43 percent; earnings before interest, taxes

depreciation, and amortization have risen by 140 percent; and enterprise value has increased by 471 percent over the period.

### **Principle 3: Work with suppliers, old and new, to build capabilities and skills**

Even companies that are sincere in their efforts can play a powerful, if indirect, role in social or environmental damage via their supply chain. One way to limit such damage is to leverage their expertise and economic clout to improve the practices of subcontractors and suppliers. The principle is clear: a company's sense of responsibility must go beyond its direct operations, not only in economic and environmental terms, but also regarding its impact on consumers, contractors, and their employees. Starbucks, for example, checks that its suppliers are paying their workers the minimum wage, do not employ children, and conserve biodiversity. During the COVID-19 outbreak, a number of companies have been paying their suppliers early, or extending credit, to keep them going.

In 2017, Walmart established Project Gigaton, with the goal of removing a billion metric tons of greenhouse gases from its supply chain by 2030. To get there, it has pursued a wide variety of initiatives, such as participating with some US-based suppliers on power-purchase agreements from renewable sources and bringing economies of scale to cut costs.<sup>3</sup> The effort has engaged more than 2,000 suppliers around the world, and progress is tracked, both collectively and individually. Three years in, the retailer is almost a quarter of the way toward its goal. It also trains and monitors suppliers to ensure fair labor practices and has cut off dozens that have systematically failed to comply with its standards.

Unilever, the global consumer-goods company, began developing its Sustainable Living Plan in 2010. One part of the plan set a goal of sourcing 100 percent of its agricultural raw materials sustainably by 2020, which resulted in the formation

<sup>3</sup> Lucy Handley, "Walmart has a grand plan to help suppliers club together to buy green energy," CNBC, October 23, 2020, cnbc.com.

of the Sustainable Agriculture Programme (SAP). It monitors 11 social, economic, and environmental indicators, including soil health, biodiversity, and human capital. SAP also sets minimum standards for its suppliers, such as those related to deforestation and human rights. To do so, it first focused on important crops, such as palm oil, sugar, and tea, and then worked with suppliers to develop ways to address the key issues. For example, Unilever requires all palm oil suppliers—and their suppliers, too—to comply with the “five principles for sustainable palm oil.” By 2019, Unilever estimated that 62 percent of its agricultural supply chain was from certified sustainable sources, up from 14 percent in 2010.

**Principle 4: Serve consumers’ long-term needs**

The internet spreads culture and information, as well as misinformation. Paint can be used to daub insults as well as to make great art. Cars move goods and people—and can crash. The point is that almost any product can do harm through poor use, malign intentions, or sheer bad luck. And while business does not want to overstep its bounds, it also does not want to be indifferent to predictably bad outcomes. Recognizing how goods and products affect consumers and then taking action to reduce the negative consequences is part of stakeholder capitalism.

Take food, for example. Eating is something people enjoy, and it is also, obviously, a necessity. But

people do not always think about what they eat—which is one of the reasons that global obesity rates almost tripled between 1975 and 2016, according to the World Health Organization. In response, a number of major companies have made changes in how they formulate their food. For example, the Swiss food giant Nestle has reduced the amount of sugar used in its breakfast cereals and also added whole grains and vitamins.

As another example, the family-owned LEGO Group’s ubiquitous interlocking bricks (which parents all over the world have tripped over since their introduction in 1958) are loved by children. But the company sees its mission as not only amusing children but also helping them develop into “the builders of tomorrow.” The LEGO Foundation’s Centre for Creativity, Play, and Learning, which gets 25 percent of company profits, researches the role of play in childhood development and creativity and sponsors programs for children—1.8 million of them in 2019—to teach emotional and cognitive skills through play. LEGO can undertake this kind of venture because it is commercially successful. After a rough patch in the early 2000s, it recovered well; revenues more than tripled from 2009–19, while profits are strong and steady. LEGO is successful because it is not afraid to change. While bricks are still their staple, new products make up more than half the portfolio every year, developed in part through intense collaboration with consumers—that is, kids—from all over the world.

**Recognizing how goods and products affect consumers and then taking action to reduce the negative consequences is part of stakeholder capitalism.**

**Principle 5: Treat your employees with respect and invest in their futures**

Labor is not just a cost to be managed. Employees are human beings and, on that basis alone, should be treated with dignity. In business terms, they are also an incredibly valuable resource, well worth tending to in the present and investing in for the future. Companies that do so could benefit in the long term by being more attractive to possible hires and inspiring greater loyalty and productivity among those they already employ.

With about 50,000 employees, California-based Salesforce is the world's largest customer relationship management company. It regularly appears on lists of "best companies to work for" because of its high level of commitment to its staff. For example, it offers them seven paid days off per year to volunteer in their communities. In the office (virtual or physical), employees can use specially developed tools to resolve internal queries. As befits a tech company, Salesforce uses data to improve on the employee experience. At every stage of an employee's career, data points are used to make better, faster talent decisions. Additionally, the company invests heavily in workforce development. Employees clearly are buying in: more than half of new hires<sup>4</sup> come from internal referrals. And there is more to come: in September 2020, Salesforce announced that it would hire 12,000 new employees in the next year.

Mondragon is a worker-owner cooperative in the Basque region of northern Spain that is one of the country's largest businesses, with revenues of €12 billion and more than 81,000 employees. Mondragon prides itself on the principle of "intercooperation," which means that when one constituent of the co-op falters, the others step in to help. When Fagor Electrodomésticos, a part of the Mondragon co-op, went bankrupt in 2013, it had 1,800 employees. Instead of immediately turning to layoffs, Mondragon reskilled them so that almost all of them were able to move to other parts of the business. Mondragon's commitment to its

employees is reflected back—productivity is 8 percent higher than and its absentee rate half that of its peers.

Finally, Haidilao is a popular Chinese hot pot restaurant chain, with hundreds of restaurants—mostly in China, but also in Canada, Japan, Southeast Asia, and the United States. It is known for the quality of its customer service and its staff loyalty—and management insists that the two go hand in hand. Branch managers are evaluated not on revenues but on metrics associated with customer and employee satisfaction. Some restaurants offer on-site babysitting; others, free manicures and shoe polishing. Customers waiting in line get snacks and games. Employees have significant autonomy; for example, they are allowed to gift a customer a complimentary meal without managerial sign-off. There is also a wide range of perks, including a dedicated fund to help employees with personal emergencies.

In a sector notorious for high turnover—40 percent a month in 2015, the last year for which data were available—Haidilao's was 10 percent and, among management, near zero. Because it promotes only from within, employees believe they can advance, maybe by attending the Haidilao College or taking a variety of training courses related to restaurant management. And when the company suffered a food-safety crisis in some of its Beijing locations, it responded with an apology and installed livestreaming cameras so customers could see the kitchens. "Putting faith in my staff has paid off for me," Haidilao's founder and CEO Zhang Yong told a conference in 2018. "Giving them responsibility and autonomy is how you show trust."

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Companies that embrace the idea of stakeholder capitalism—an orientation that we think can apply to a wide range of business models, including start-ups and small and medium-size enterprises—may have to deal with backlash. Short-term-oriented

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<sup>4</sup> "100 best companies to work for," *Fortune*, 2020, fortune.com.

investors may believe their returns are suffering. Employees could be irritated if they believe their expectations are not being met. Competitors will be happy to jump on any bad news.

And for some people, nothing a company does will be enough. There have been, and will be, cases where companies announce and try hard to reach specific stakeholder goals—and then fall short, facing disapproval for their failure. Imperfection is a fact of life and, certainly, of business.

Making stakeholder capitalism work, then, is a matter of striking a delicate balance among

competing priorities; after all, fair is not always equal. Companies need to be ready to change their answers because the questions certainly will change. Real progress will take time. And while there may be setbacks, that doesn't mean the journey is not worthwhile.

We believe, as many business leaders do, that a company is more than a balance sheet. It is an expression of human bonds, a living entity that is sown and grown and whose harvest is lives and livelihoods. Stakeholder capitalism is a way to plant those seeds.

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# Help your employees find purpose—or watch them leave

Employees expect their jobs to bring a significant sense of purpose to their lives. Employers need to help meet this need—or be prepared to lose talent to companies that will.

*by Naina Dhingra, Andrew Samo, Bill Schaninger, and Matt Schrimper*

**If the tumult of 2020** has prompted your organization or leadership team to reconsider people priorities such as employee well-being, resilience, or purpose, then you're in good company.

Your employees are reconsidering you, too.

Nearly two-thirds of US-based employees we surveyed said that COVID-19 has caused them to reflect on their purpose in life. And nearly half said that they are reconsidering the kind of work they do because of the pandemic. Millennials were three times more likely than others to say that they were reevaluating work.

Such findings have implications for your company's talent-management strategy and its bottom line. People who live their purpose at work are more productive than people who don't. They are also healthier, more resilient, and more likely to stay at the company. Moreover, when employees feel that their purpose is aligned with the *organization's* purpose, the benefits expand to include stronger employee engagement, heightened loyalty, and a greater willingness to recommend the company to others.

Nonetheless, if you're like most senior executives, you haven't given the individual purpose of your employees much thought. The topic is intensely personal, potentially inaccessible to employers, and seemingly as uncomfortable to discuss as it is to actively encourage.

Despite these challenges, our research found that 70 percent of employees said that their sense of purpose is defined by their work. So, like it or not, as a company leader you play an important part in helping your employees find their purpose and live it. And you have your work cut out: our survey also found disparities in how frontline employees and other groups feel supported—or thwarted—in living their purpose at work.

In this article, we describe the role that work can play in individual purpose, highlight what employees want from employers and what they aren't getting, and describe what you can start doing about it. The prize? If you get this right, you can help your company become a better place to work and tap the enormous business potential of a purposeful workforce aligned with a purpose-driven organization.

But be careful: purpose is not just “another corporate initiative.” You can't mandate this. And if you approach your people with inconsistency, hypocrisy, or arrogance, you will likely do the organization—and your reputation—more harm than good.

## Understanding purpose at work

To understand the challenge, we surveyed more than a thousand US employees about individual purpose and the work and life outcomes associated with it.<sup>1</sup> The survey is part of an ongoing McKinsey research effort to better understand the role of purpose in organizations.

Before exploring the findings, though, it's useful to consider the context in which individual purpose operates at work, as well as the unique challenges it presents for employers. Individual purpose can be thought of as an enduring, overarching sense of what matters in a person's life; people experience purposefulness when striving toward something significant and meaningful to them. There are clear patterns, or purpose archetypes, that help employers categorize what people find meaningful, but ultimately someone's purpose can be as varied as people themselves.

The upshot is that while companies and their leaders can have a big influence on the individual purpose of their employees, they have limited direct control over it. Companies therefore

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<sup>1</sup> This article draws upon a survey we conducted in August 2020 of 1,021 US workers. The respondents represented a range of ages, incomes, roles, and tenures.

need to meet employees where they are in order to help them optimize their sense of fulfillment from work.

To better understand how to accomplish this, consider the conceptual relationship between an individual's purpose and their work, as depicted by the three concentric circles in Exhibit 1. Everyone's purpose may be unique, but some part of it—large or small—comes from forces outside work, just as some part comes from the daily work itself. These are the outermost and middle circles, respectively, and they vary in proportion to each other from person to person.

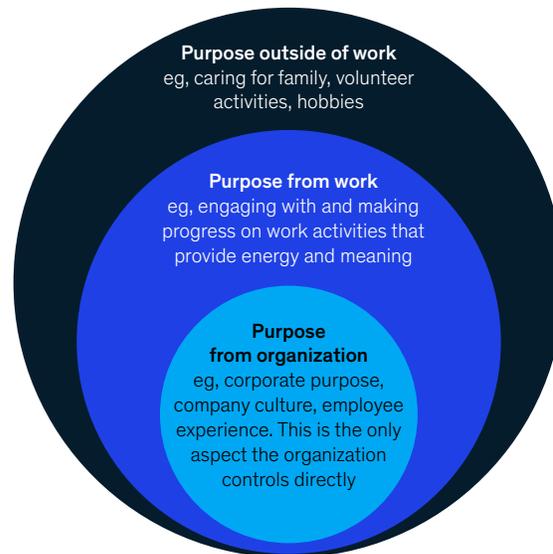
If an employee gets very little purpose from their work, the size of the middle circle will be smaller. By contrast, if another person finds their work very purposeful, it will be larger. Intuitively, then, the size of the middle circle represents the portion of one's purpose that is accessible by work—and also how much purpose employees want from their work—and it may grow or shrink. Employers should view this middle circle as a target they strive to understand and meet. They should influence the expansion of this circle if they can.

The innermost circle (purpose from the organization) depicts the company's means of

Exhibit 1

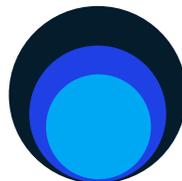
## Meet employees where they are to help them achieve fulfillment at work.

### The relationship between individual purpose and work



### Three scenarios

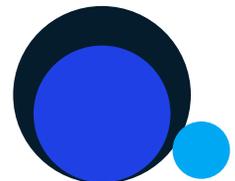
**Nicole's** purpose from work is aligned with and fulfilled by her company's purpose



Although she's aligned with the company's purpose, **Nancy** isn't feeling fulfilled by it in her work



**Katherine's** purpose is misaligned with—and unfulfilled by—the company's purpose



influence; it's the only aspect of purpose that organizations control. How so? By establishing a corporate purpose that considers the company's role and contribution to society, and by providing employees with meaningful ways to reflect on the company's efforts and their impact. Companies can also exert influence by improving the underlying health of the organization and its culture, bolstering inclusiveness and the employee experience, and changing the work itself.

As a company leader, you want to see the organization's relatively small sphere of influence expand to match the size of the employee's own sense of purpose from work (the middle circle). The closer the company gets, the more fulfilled the employee is. Moreover, a closer match earns the company more opportunities for employees to seek—and expect—more purpose from work, and to feel more aligned with the organization's purpose.

The operative word here is “earn.” Remember that when it comes to purpose, you have access only to what your people *grant* you access to. Your first task is to learn what they want, and then to see if they're getting it.

## What employees want—and what they get

Chances are, your employees want more purpose from work than they're getting. For starters, we know that employees at all levels in the organization say that they want purpose in their lives. Eighty-nine percent of our survey respondents agreed, a proportion that tracks closely with academic research.

Moreover, 70 percent of the employees we surveyed said that their sense of purpose is largely defined by work. Senior executives in our sample nudged that average upward, but even so, two-thirds of nonexecutive employees said that work defines their purpose. This signals a clear opportunity for employers and leaders—an open door to encourage your employees at all levels to develop and live their purpose at work.

Yet when we asked if people *are* living their purpose in their day-to-day work, the gap between executives and others mushroomed. Whereas 85 percent of execs and upper management said that they are living their purpose at work, only 15 percent of frontline managers and frontline employees agreed. Worse, nearly half of these employees *disagreed*, compared with just a smattering of executives and upper management (Exhibit 2).

This “purpose hierarchy gap” extends to feeling fulfilled at work. Executives are nearly eight times more likely than other employees to say that their purpose is fulfilled by work. Similarly, executives are nearly three times more likely than others to say that they rely on work for purpose. Interestingly, the group most reliant on work for purpose—across roles—are parents (see sidebar, “Meet the parents”).

Finally, we sought to quantify the scope of the overall challenge for companies by comparing respondents' answers, regardless of their role, to questions about their desired and actual states.<sup>2</sup> This revealed that only 18 percent of respondents believed that they get as much purpose from work as they want. Sixty-two percent said that while they get *some* purpose from work, they want to get even more.

## Understand the implications

You might consider “getting some but wanting even more” to be pretty good, particularly if you lead or manage big groups of people. You'd be wrong. These less satisfied respondents reported lower average work and life outcomes than more satisfied peers did—everything from reduced feelings of energy and life satisfaction to lower engagement, satisfaction, and excitement about work (Exhibit 3). Negative work and life outcomes for employees inevitably translate to negative outcomes for the business.

Moreover, the subtlety of some of the findings around frontline employees masks deeper issues. Why, for example, are frontline managers and employees so much less likely than others to rely

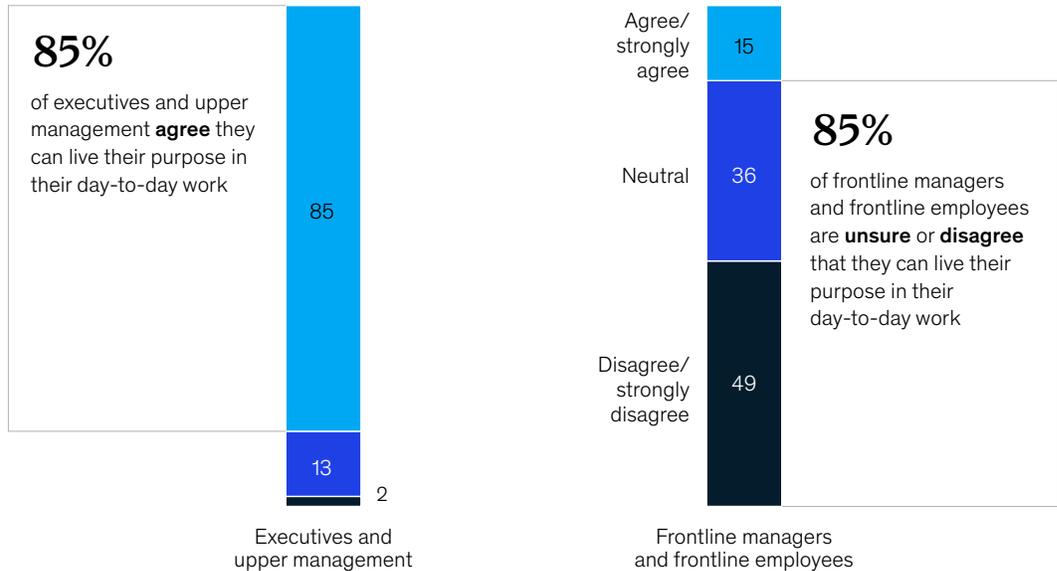
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<sup>2</sup>We did this by mapping employees' answers to two questions: “How much of your work needs to be aligned with your purpose?” and “To what extent is your purpose defined by work?”

Exhibit 2

## A stark 'purpose gap' exists between upper management and the front line.

Living your purpose in day-to-day work, % of respondents (n = 1,021)



Source: McKinsey Individual Purpose survey, August 2020

on work for purpose? The numbers suggest that shortsighted leaders may be conditioning them to feel this way. Indeed, when we dug further into the data we saw that frontline managers and employees were ten times less likely than

management-level colleagues to say that they'd had opportunities to reflect on their purpose, and nine times less likely to say that they'd had a manager foster opportunities for them to work on purposeful projects. Similarly, managers don't

## Meet the parents

**Any parent will tell you** that having children is life altering. Intriguingly, this axiom appears to extend to purpose as well. Parents in our survey were 1.6 times more likely than nonparents to say that they had a clear understanding of their purpose, and they were more than twice as likely to say that that they relied on work for purpose.

Time always feels scarce, so given the trade-offs that parents make between work and home, our findings suggest that parents are keen to make work time as meaningful as possible. These findings could also reflect the "big picture" shift in perspective that many people describe as a consequence of parenthood.

Both sentiments were echoed in focus groups that we conducted independent of the survey mentioned in this article. In that forum, one parent remarked: "I felt more invested in the future after having kids. It changed my vision of the long game." While another noted, "Being a parent has made my priorities more clear about my impact on the world. I want to make my children proud."

seem to be doing much to share the “big picture” with frontline colleagues, who were three times less likely than leaders to say that they can see a connection between their daily work and the organization’s purpose.

While such gaps should distress you—many of the employees closest to your products and customers may have stopped relying on you for the purpose they say they want—the findings also offer hope.

When employees at any level say that their purpose is fulfilled by their work, the work and life outcomes they report are anywhere from two to five times higher than those reported by their unfulfilled peers. And this finding holds regardless of whether

employees currently rely on work for purpose. In other words, organizations should aspire to ensure that their employees’ purpose is fulfilled at work, whether or not employees initially think they rely on work for this. Employees—and the organization—stand to benefit anyway.

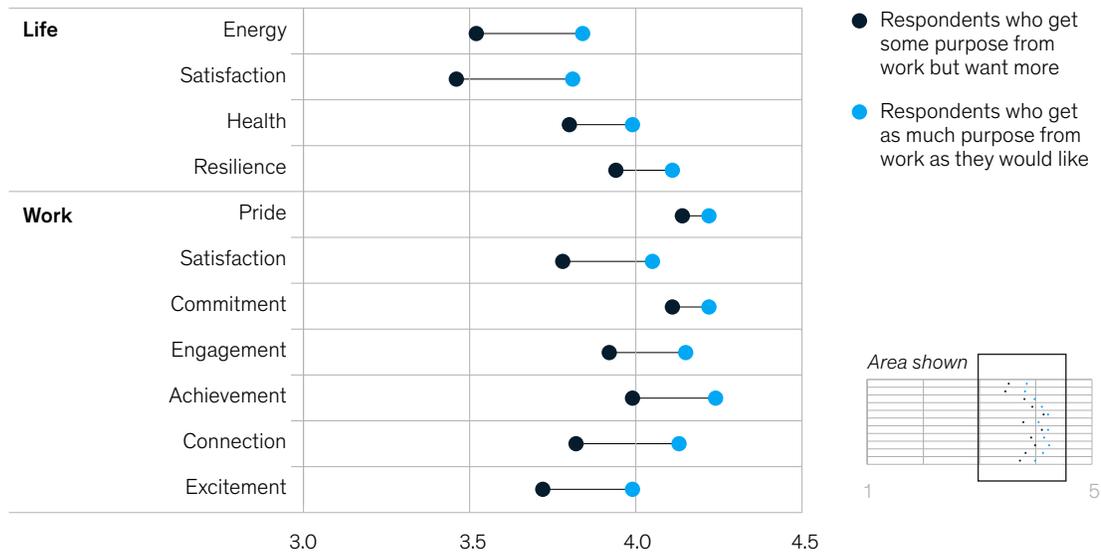
### Take action, thoughtfully

The choices that company leaders and managers make are the X factor in helping employees fulfill their purpose at work. By making better choices—starting now—you can make a positive difference in the lives of your colleagues and the performance of the company. Here are three ways to focus your efforts:

Exhibit 3

## Employees who get the purpose they want from work report better outcomes at work—and in life—than their less-satisfied peers.

Purpose in day-to-day work,<sup>1</sup> score (5 = high, 1 = low; n = 1,021)



Note: All the differences shown between the 2 groups of respondents are statistically significant except for work pride and work commitment, although both are directionally consistent with the other findings.  
<sup>1</sup>Question: “To what extent is your individual sense of purpose defined by work?” vs “How much of your work needs to be aligned with your purpose?”  
 Source: McKinsey Individual Purpose survey, August 2020

### **1. Start with the organization's purpose (hint: the only thing you control directly)**

It may seem counterintuitive to look first to the organization's purpose in hopes of supporting the life purpose of your employees, but remember: this part you control. Does your company meaningfully consider its role in society? Do senior executives use the company's purpose as a North Star to make difficult decisions and trade-offs? If your company's purpose is just a poster on the wall, you're wasting everyone's time. If you talk about purpose but don't follow through, the results can be devastatingly bad.

If you aren't sure your leaders are following through, start checking. Some companies use internal scorecards to track the commitment of leaders, employees, and other stakeholders to organizational purpose. Routine measurement helps leaders encourage buy-in, spot problems early, and take appropriate action. A few companies go further and embed purpose metrics into the performance assessments of people leaders.

One action you can take today is to start spending time with your team reflecting on the impact the company has on the world. Again: this must be earned. Cringeworthy emails to your team about corporate social responsibility efforts that seem disconnected from the team's day-to-day experience will only inspire cynicism. You want dialogue, not monologue. Still, when authentic and handled well, reflections on the bigger picture can inspire a sense of purpose. Our survey found that employees are five times more likely to be excited to work at a company that spends time reflecting on the impact it makes in the world.

### **2. Reflect, connect, repeat**

When employees have a chance to reflect on their own sense of purpose, and how it connects to the company's purpose, good things happen. Survey respondents who have such opportunities are nearly three times more likely than others to feel their purpose is fulfilled at work. Make this a habit in your company.

While leadership workshops and storytelling sessions can be good forums for this, keep in mind that the underlying problem you're trying to solve might be in your leadership environment. Managers must be prepared to share their own purpose with others, for example, and be vulnerable in ways they're likely not used to in order to role model these skills and pass them along to colleagues. And pass them along you must: people in our survey whose managers didn't provide them opportunities to reflect on purpose stood just a 7 percent chance of fulfilling their purpose at work.

Look closely at your managers and leaders. Do they cultivate compassionate leadership, or is the attitude more akin to "stop whining"? Ask yourself: Is my team comfortable sharing personal things with me? Few things are more personal than one's purpose in life, and if psychological safety is low at your company you will never learn that firsthand. When employees in our survey said they experienced little psychological safety, they stood a 0.5 percent chance of saying their purpose was fulfilled at work.

### **3. Help people live their purpose at work**

Sixty-three percent of people we surveyed said they want their employer to provide more opportunities for purpose in their day-to-day work. You need to find ways to deliver.

Many companies are tempted to scratch this itch by implementing programs that support employees' purposeful impulses wherever they find them—in the community, for example, or even elsewhere in the world. Some companies offer paid time off for these pursuits.

While such efforts are laudable, and even beneficial, they are not a good solution to the problem our survey identified. Your starting point should be opportunities that help employees find more personal meaning in their day-to-day work. By doing your part to help employees live their purpose at work, you will enable them to feel more fulfilled. And when the work is aligned with the company's

own purpose, that sense of fulfillment will ultimately benefit the company, too.

Consider the example of North American insurer USAA under then-CEO Joe Robles. To establish commitment to its core customer base in the US military community, Robles (who retired from USAA in 2015) saw to it that every employee went through a four-day orientation. Town hall meetings and other forums reinforced the effort by encouraging employees to ask questions and share ideas about how to fulfill their purpose.<sup>3</sup>

Purposeful employees try harder and are more apt to innovate. As reported in 2018, USAA's employees had collectively submitted more than 10,000 ideas to the company each year to improve the customer experience. About 900 had been awarded patents, including 25 authored by one of the company's security guards.

Town hall meetings and immersive, small-group sessions may not sound as sexy as a paid leave

of absence to do good in the world, but they are a lot more effective at helping employees start to see the good they can do in their day-to-day work. Many people spend the majority of their waking hours at work, so creating space for the little things to become purposeful can quickly snowball into better work experiences—and better work environments—for everyone.

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The COVID-19 pandemic has people everywhere reevaluating their lives and work, and many now expect their jobs to be a significant source of purpose in their lives. Employers—ready or not—will have to help meet this need—or be prepared to lose talent to companies that will. The good news? The benefits of getting individual purpose right are substantial, self-reinforcing, and extend not only to the well-being of employees but also to the company's performance.

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<sup>3</sup>For more, see Robert E. Quinn and Anjan V. Thakor, "Creating a purpose-driven organization," *Harvard Business Review*, July–August 2018, Volume 96, Number 4, pp. 78–85, hbr.org.

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# More than a mission statement: How the 5Ps embed purpose to deliver value

Your company's purpose strengthens resilience and creates value—if it's genuine. A new framework highlights a detailed approach to embedding purpose throughout your organization.

*This article was a collaborative, global effort by Sebastian Leape, Jinchen Zou, Olivia Loadwick, Robin Nuttall, Matt Stone, and Bruce Simpson.*

**We've all seen it:** companies that have the “it” factor, an enthusiasm and passion that lights up employees, delights customers, and shines for investors. It's not just the company's warmer fleece, or a more delicious ice cream, or even a breakthrough technology. And it's so much more than just a mission statement. It's purpose. Purpose answers the question, “What would the world lose if your company disappeared?” It defines a company's core reason for being and its resulting positive impact on the world. Winning companies are driven by purpose, reach higher for it, and achieve more because of it. Competitors wonder where they can get some of that magic and how they might sprinkle it on.

If that's your expectation—that purpose can be added easily to your mix—get ready to be disappointed. A superficial approach to purpose doesn't work. In fact, it can do considerable harm, opening up your company to accusations of inauthenticity or “purpose-washing,” turning off customers or driving them away completely, and disaffecting employees up and down your organization. Poor outcomes follow when purpose is a patch job.

Yet the positive corollary also holds: companies with a genuine, lived purpose radiate authenticity and do well by doing good. Customers, suppliers, partners, and investors recognize the value proposition. Senior leaders allocate capital and resources with purpose in mind. And employees think about purpose all the way, making it a part of their decision making as a matter of course. Building those dynamics doesn't come easily. It requires leaders to embed purpose throughout the organization. As we've described before, purpose must connect with your company's “superpower”—its unique ability to create value.<sup>1</sup> Purpose is not the same as environmental, social, and governance (ESG) (see sidebar, “Purpose, ESG, and the 5Ps”). Purpose is your company's *raison d'être*.

In this article, we describe a framework that organizations can use to make purpose real, steer clear of potential vulnerabilities or blowback, and help unlock meaningful value. We call this framework the 5Ps.

## **A framework for purpose: The 5Ps**

It's relatively easy to develop a mission statement or kick off a purpose initiative. Most organizations have sought to define their purpose at some point or other, and many think it important to ensure that the company's purpose is embedded in everything it does. But leaders also know that's not easy. Perhaps that's why companies announce purpose changes so often. “We've had so many purpose initiatives,” one European group CEO told us, that “at this point, they just wash over me.” A useful analogue is transformations; about 70 percent of them fail to reach their stated goals, in large measure because they fail to change—and sometimes fail to even think of changing—the mindsets and behaviors of employees. Purpose should be systemic and rational, but also emotional; it should resonate with members of your organization and inform their decision making. Five major elements are critical:

1. **Portfolio strategy and products:** the products and services your organization provides, and the “where to play” and “how to play” choices you make to best serve your customers
2. **People and culture:** the talent—and the talent management—your firm deploys
3. **Processes and systems:** the operational processes you adapt to meet purpose-related targets; the ways you ensure that behavior up and down your value chain is in line with your purpose
4. **Performance metrics:** the target metrics and incentives you use to measure what you wish to achieve, how your firm is progressing, and the way you create and distribute incentives to make your organization's purpose tangible
5. **Positions and engagement:** how you align your external positions and affiliations to be consistent with, and consistently deliver on, the purpose your company has defined

These elements are depicted in the exhibit on the following page.

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<sup>1</sup> “Purpose: Shifting from why to how,” *McKinsey Quarterly*, April 2020, McKinsey.com.

## To embed purpose in your company and deliver value, follow the 5Ps.

### 1 Portfolio strategy and products

- Redefine product portfolio—eg, withdraw some products, introduce new products
- Revise pricing in line with purpose
- Review portfolio and test purposefulness of individual assets against common criteria



### 2 People and culture

- Align recruiting, people development, and career pathways to enable purpose
- Define purpose KPIs and hold employees accountable/give them incentives to meet targets
- Articulate and role-model desired individual mindsets and behaviors linked to purpose



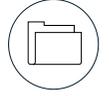
### 3 Processes and systems

- Adapt operational processes to meet purpose-related targets
- Ensure supplier behaviors are in line with purpose



### 4 Performance metrics

- Set performance targets and metrics in line with purpose
- Introduce capital-allocation metrics in line with purpose for decisions (eg, capital expenditures, M&A)



### 5 Positions and engagements

- Tailor external engagement and communications to purpose
- Revise external positions in line with purpose
- Align affiliations (eg, trade-association membership) with purpose



These five levers consistently elevate purpose over the long term, but they must be regularly, and rigorously, adjusted over time. Don't kid yourself; there may be uncomfortable decisions to make, and often hard trade-offs as well. In every case, start by understanding the sources of your company's strength and address the areas in which it is vulnerable. Then, build out your purpose infrastructure in a programmatic way.

### 1. Portfolio strategy and products

Demonstrating purpose in the products and services you offer is a two-step process. First, make sure that your business portfolio aligns with your company's purpose. While most companies will not, of course, be able to start from a clean slate in terms of the industries and sectors in which they compete, almost all can identify ways to reshape their business mix in an active, purposeful way. Second,

once you have chosen your portfolio, fill out its businesses with products and services that match your company's purpose, and winnow out those that don't. Fight the tendency to approach purpose with a "this is the hand I've been dealt" resignation. Of course your company's endowment matters, but you have greater freedom than you might expect to choose what your company does and how it can make a positive difference.

Consider bp. The former British Petroleum has been an energy company since its founding over a century ago, operating in extractive industries around the world. Yet that legacy has not constrained bp from reimagining what an energy company can be. The firm has pivoted sharply, adopting as its purpose "reimagining energy for people and planet"; it has not only exited its petrochemicals businesses but also announced a plan to shrink its legacy oil and gas businesses by 40 percent by 2030, to scale

up its low-carbon energy businesses (such as bioenergy, hydrogen, and electric-vehicle charging) significantly, and to put itself on a path to become a net-zero carbon emitter by 2050 or sooner.

In fact, there is ample precedent for bold, purpose-based portfolio shifts. For example, DSM (Dutch State Mines), a Netherlands-based company, was originally incorporated to mine coal and, over a century, evolved into one of Europe's largest bulk chemicals companies. But, by going deep on purpose and insisting on a "triple bottom line" of people, planet, and profit, DSM showed that it could set a radically different course. From 2001 to 2015, the company not only divested from businesses such as petrochemicals and ammonia but also made more than 25 acquisitions in food, feed, and nutrition, among other business lines, transforming itself into an innovative specialty-chemicals leader.

S&P Global offers another illustration: to meet its purpose of accelerating progress in the world by providing intelligence that is essential for companies, governments, and individuals to make decisions with conviction, it shifted from a wider range of more generalized information and publishing businesses to a focus on research and analytics. Over a decade of change, it remained an information company, but it transformed itself into a different kind of information company—and a manifestly more purposeful one, seeking to meet the information needs of its stakeholders and broader society.

Creating value for all of your stakeholders by having a positive social impact is a bold decision and can require hard choices, such as CVS's decision in 2014 to remove tobacco products from its pharmacies. But, as our research has shown, strategic fortune—measured across industries, and considered in the aggregate—favors the bold. In fact, companies that keep a static portfolio serially underperform.

Few companies have embedded purpose as thoroughly as Patagonia does. The California-based outdoor-equipment and -clothing business

has always been purpose driven; it was the first company in its state to become a benefit corporation (a corporate form that enables directors as a matter of law to extend their duty of loyalty beyond shareholders), and is also a certified Benefit Corporation, or "B Corp." For decades, Patagonia's mission had been, "Build the best product, cause no unnecessary harm, use business to inspire and implement solutions to the environmental crisis." Yet in late 2018, founder Yvon Chouinard made the company's purpose even more bold: "to save our home planet." Purpose gives Patagonia the impetus to expand into multiple new businesses, such as food, in an effort to spur on new advances in regenerative agriculture. The company also creates films and books about environmental activism and launched Patagonia Action Works (PAW), a platform for matching volunteers with activist causes across different communities.

As Patagonia's example suggests, your company's purpose should drive decision making about portfolios and then inform your choices about the products and services you offer within those portfolio businesses. Your decision making will be sharpened further by following the heuristics of superpower ("What is the unique way that our company can create value and drive progress?") and vulnerability ("What choices could we make that would be particularly discordant with our stated purpose?").

Alphabet, for instance, prioritizes its mission to promote "freedom and focus." It makes sense, therefore, that the Google Play app store no longer offers apps for personal loans that carry excessive annual percentage rates, such as those of predatory payday loans. Toy companies are profitably replacing dolls with unrealistic bodies with offerings that are more true to life. Banks and financial institutions meet customer needs by introducing green auto loans, green mortgages, and green insurance; Swedish fintech Doconomy, for example, offers credit cards with built-in CO<sub>2</sub>-emissions limits. Purpose-washing? Not when the products and services offered are moored to an organization's authentic, lived mission.

## 2. People and culture

The second lever for embedding purpose could, just as plausibly, be considered the first: people and culture. Purpose begins with human beings. Your employees, indeed all of your stakeholders, are your sources of strength and a hard check against inauthenticity. That's why employee sentiment is often the single greatest force undermining insincere claims of purposefulness. Think, for example, of digital-native companies that have bold, change-the-world mission statements but nonetheless find themselves tripped up by accusations of "bro cultures," or businesses called out for marketing aspirational messages while using labor from prison systems. In other cases, companies that have championed inclusivity have subsequently been accused of discriminatory behavior at the front lines.

Purpose can be aligned at critical points with your people and culture. That starts with hiring. Managers can actively screen for individuals who share the values that support the company's purpose. As a senior leader of one high-performing activewear company told us, "We hire people who reflect the values of the company. We never hire bad people hoping we can change them." Human-resource decisions grounded in purpose should also be reflected in people development and career pathways; being consistent and genuine will reinforce a virtuous circle throughout your organization. Managers should also articulate and role-model the mindsets and behaviors linked to company purpose and hold employees accountable for meeting targets. As the CEO of one Asian company recently told us, alignment with a company's purpose can't just be "management saying some nice words and calling it a day." But when the company identifies what it wants in a key performance indicator (KPI), good managers "get it done."

Decision making about your people and culture also includes capturing opportunities as they arise. At a 2019 annual general meeting, a bp employee raised her hand to ask, "When is bp going to give [employees] jobs that are meaningful?" Impressed, senior executive (and now CEO) Bernard Looney promoted her a short time later to the role of "purpose engagement manager," with the remit to

work with employees to further the company's vision of reimagining energy.

The quest for meaning is part of the human condition and is embraced, not squelched, by purposeful organizations. Our research shows that employees at purpose-driven companies are four times more engaged at work—a powerful source of competitive advantage. Consider Best Buy. Former CEO Hubert Joly transformed the consumer-electronics retailer to a model in which customer service, powered by the human touch, would be the differentiator. Under his direction, the company moved to invest heavily in employee training; provide employee discounts to encourage its own people to buy, use, and then recommend products to others; and advance Geek Squad, enthusiastic agents who help choose, install, personalize, and support products that Best Buy sells. That reinforced Best Buy's purpose to enrich lives through technology and helped make the business more enjoyable for customers and employees alike.

Indeed, it's hard to overexaggerate the importance of employee commitment. London Business School professor Alex Edmans demonstrated that companies that invested significantly in employee well-being outperformed their peers in stock returns by 2 to 3 percent a year. That makes sense; how enthusiastic, really, should we expect employees to be if they are just punching the clock? Thus, when PayPal CEO Dan Schulman dramatically boosted employee pay in 2019 and increased benefits and made all employees shareholders in the company, he did so precisely with purpose in mind. Passionate employees radiate enthusiasm to customers and communities alike.

Your people can also be your best barometers of progress. Investigations into the banking industry over recent decades are littered with examples of early-warning signals from employees of poor conduct, the misselling of products, and faulty product design. Many of these signals either fell on deaf ears or were willfully ignored. Ensuring that your people have appropriate mechanisms and tools supported by a "speak up" culture to identify gaps is critical to embedding purpose.

## Purpose, ESG, and the 5Ps

What's the difference between purpose and ESG—and how do the 5Ps fit in?

A useful framing, we find, is to compare the *breadth* of ESG with the *uniqueness* of purpose. ESG encompasses society's wide range of expectations about the role of business. There are a multitude of ESG options, requirements, and variations—from community service to inclusivity, transparency in reporting, and waste management, to name just a few. Purpose, on the other hand, helps your firm prioritize among all the things it can (and sometimes must) do in ESG. It directs you toward the areas where you want to “win” as opposed to the areas where you want to “play”—that

is, where you can meet the societal bar but, for want of time and resources, can go no higher, at least for now.

Once you've determined which ESG initiatives are your “musts,” the next step is to embed them in your organization. The 5Ps can serve as a practical checklist. Consider governance. Effective governance can strengthen an organization's bond with its *people and culture* (for example, through employee safety and nondiscriminatory hiring and promotion); enforce principles and standards about *portfolio strategy and products* (such as product-safety guidelines and the effects of those products on society and the planet); help *processes*

*and systems* work to best effect (ensuring, for example, that suppliers are accountable); and assure that *performance metrics and positions and communications* are true and transparent. Good governance may also provide the impetus for a company to form or reconstitute as a public-benefit corporation, or seek B-Corp certification.

When leaders actively seek to embed purpose throughout their organizations, ESG feels less like a cost of doing business and more like a source of competitive advantage. That comes from your purpose being authentic and infused throughout your organization, not forced or tacked on.

### 3. Processes and systems

The third lever, processes and systems, addresses a core “how” of your business model: the operational initiatives, incentives, and governance mechanisms your firm relies upon to create value and to realize its purpose. It takes robust systems to keep (or start) the purpose engine humming. Some elements, of course, will be industry and business dependent. For example, food companies can identify and source healthier ingredients from their farmers, and more environmentally friendly materials from their packaging suppliers. But, regardless of sector, most companies can embed best practices, from cafeteria composting to paid leave for community service.

Your processes and systems initiatives should do the same, with considered planning for the present and future. Take, for example, Microsoft's approach to carbon emissions. The company already worked to be carbon neutral (a goal it achieved in 2012), and

has since aimed even higher: by 2025, Microsoft expects to consume only renewable energy at its data centers, buildings, and campuses; and the company plans to completely electrify its global campus operations vehicle fleet by 2030—the year the company has announced it will be carbon negative. While some organizations track carbon to create nominal (though meaningful) “carbon-adjusted” financial reporting, Microsoft already assesses an internal carbon fee on its business divisions. Funds from the assessment are used to invest in further carbon-reduction efforts within the firm, and to contribute to environmental causes worldwide.

Indeed, when embedding purpose in your company's processes and systems, it's vital to look beyond the firm's four walls. Walmart's Project Gigaton, for example, embraces its entire supply chain: the program aims to help suppliers eliminate

one gigaton of greenhouse gases by 2030. As part of the initiative, Walmart identified six categories in which suppliers should reduce emissions: energy, waste, packaging, forests, agriculture, and product use and design. It then built a platform to help suppliers chart their emissions reductions. Suppliers come up with their own emissions-reductions goals, which must be “SMART”—specific, measurable, achievable, relevant, and time limited. They are also required to report their progress annually, and top achievers receive recognition on Walmart’s sustainability hub website. Hundreds of suppliers currently take part, and Walmart expects even more to join.

As BHP’s CEO, Mike Henry, recently shared, embedding purpose throughout the supply chain is proving to be a source of resilience, even in the face of COVID-19.<sup>2</sup> From the start of the pandemic, BHP moved to support its small, local, and Indigenous suppliers by reducing payment terms from 30 days or more down to seven days. The company understood that these suppliers would be vulnerable, and sought to play a role in supporting them. That resonates. “When [suppliers] have seen that we’re there for them in their time of need, they’ll be there for us in our time of need,” Henry explained. “And that’s what we’ve seen. They’ve invested greater effort to ensure that they can continue to support BHP and keep the commitments they’ve made to us.”

#### 4. Performance metrics

Purpose can and should be measured rigorously. In practice, this means identifying the key performance indicators that tie to your company’s purpose, tracking them over time, and incenting your organization to meet purpose targets. What gets measured gets managed, as Peter Drucker famously observed. The converse is perhaps even more apt: what you seek to manage should be measured, and on a consistent basis. Too often, companies confuse, and then conflate, ESG benchmarks with purpose metrics. Standards from third-party organizations such as the Global

Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB), while important, should never become the ESG reporting “tail” that wags the purposeful company’s dog. Purpose should come from within and guide the unique metrics you measure and track. If your company starts with ESG reporting and then “backs into” a purpose, it’s getting purpose backward.

Since purpose expresses what your company is and aspires to be, purpose metrics should inform not only day-to-day operations but also allocation decisions such as capital expenditures and M&A, as well as company-wide transformation initiatives. A number of energy companies, for example, now tie executive compensation to emissions. One leading retail bank, to take another case, found itself prominently featured in a national scandal in which several financial institutions in the country had committed different regulatory breaches. The harsh negative publicity prompted hard thinking about the bank’s fundamental purpose and its relationships both with broader society and individual customers, and about how to identify, measure, and improve its purpose-based performance. Part of that purpose focused on improving customer outcomes.

One way the bank oriented toward a more purposeful outcome was to redesign incentives. The bank’s previous incentive structure included volume-based targets. Although financially not significant, reducing the weight of volume-based targets in performance evaluations was regarded by the bank as critical to its purpose shift, if only for symbolic reasons. But, remarkably, after reducing the weight of volume-based targets, the bank proceeded to financially outperform its peers. Quality of purpose, and the broad activities and behaviors that underpin its purpose, proved to be more influential than quantity. The bank now takes a more balanced approach to the measurement of, and reward for, the performance of frontline staff and managers. It incorporates a broader set of metrics related to customer outcomes, including, for example, the number and extent of interactions with customers to better understand their needs.

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<sup>2</sup> “Prioritize people in times of crisis: An interview with the CEO of BHP,” *McKinsey Quarterly*, August 2020, McKinsey.com.

There are a range of tools and KPIs that companies can use, but, because purpose is bespoke, off-the-shelf solutions almost never have the same impact as those that are carefully tailored. Moreover, measuring and activating should not be limited to monetary incentives. Companies can encourage community outreach by celebrating offices and employees who contribute measurably to the organization's mission. Businesses can also use behavioral economics to "nudge" for positive behavior, such as energy saving or waste reduction. We've found, too, that simply *showing* employees and other stakeholders how the organization is progressing along metrics such as diversity or sustainability—information that can be presented clearly in standardized reports—reinforces purpose and builds momentum for more.

It's a fair critique to say that purpose can feel orthogonal, particularly at the start of a purpose-focused initiative, because, in a prior way of doing things, it may indeed have been orthogonal. But as employees and other stakeholders are presented purpose-based metrics on a routine basis—numbers of employees from underrepresented groups, for example, or contracts with minority suppliers or customers—purpose will feel more comfortable. It becomes standard procedure.

## 5. Positions and communications

What's true within your organization should be consistent beyond it: purpose should be embedded into how your organization conveys information to and engages with the public. It's within this "P" that charges of "purpose washing" are most likely to arise—and understandably so. Artificial expressions of purpose ring false, and stakeholders recognize inauthenticity. The Edelman Trust Barometer, for example, found that two-thirds of respondents agreed that "[a] good reputation may get me to try a product, but unless I come to trust the company behind the product, I will soon stop buying it."<sup>3</sup> More than half of respondents also believe that every brand has a responsibility to get involved in at least one social issue that does not directly affect its business.<sup>4</sup>

The growing ascendance of the belief-based consumer is a powerful opportunity for many companies to step up much more visibly on the "S" element of ESG and strengthen their social license to operate. One way to do so is to consider the trade associations your firm supports—or perhaps no longer should. Both Royal Dutch Shell and bp, for example, undertook extensive reviews of those receiving their support and ultimately withdrew from a number of trade associations because they were deemed inconsistent with the company's purpose. Another action is to step up your philanthropy and corporate giving, making those efforts of a piece with your business model. Doing so in an authentic way, linked to your company's superpower and demonstrable to those around you, can strengthen your organization's ties with its community and burnish its social license. General Mills, for instance, aligns its 150-year old philanthropic foundation to share food expertise by partnering with employees in the communities in which they live and work. As well, Philippines-based conglomerate Ayala Group spearheads "Project Ugnayan," a private-sector partnership working with hundreds of local companies to help feed millions of people in the Greater Manila area.

When purpose is hardwired, your company's positions, communications, and external engagement become logical extensions of your business model; purpose eliminates the gap between walk and talk. Consider Takeda, headquartered in Japan, and one of the world's largest pharmaceutical companies. The organization strives, as CEO Christophe Weber explained, to "put [its] employees and patients first."<sup>5</sup> When COVID-19 hit, it was among the first pharmaceutical companies in many countries to pull its field force and put a hold on marketing calls. "For us," Weber related, "that was an easy decision."

Or consider Microsoft, which has a strong commitment "to empower every person and every organization on the planet to achieve more." The company announced that it would be closing all of its brick-and-mortar stores and focusing its retail

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<sup>3</sup>Edelman Trust Barometer Special Report: *In brands we trust?*, Edelman, June 18, 2019, edelman.com.

<sup>4</sup>Ibid.

<sup>5</sup>"How Asia's largest pharma is leveraging its values to navigate the COVID-19 crisis," *McKinsey Quarterly*, July 2020, McKinsey.com.

operations on digital storefronts. That hard decision was a while in the making, and was finalized during the economic downturn brought about by COVID-19. Remarkably, however, Microsoft decided that the store workers will now continue serving customers from corporate facilities and remotely, providing digital sales, training, and support.

Purpose is a source of competitive advantage, but it must be genuine and infused in your organization's business model. The 5Ps provide a framework to help companies embed purpose in a systematic, holistic way. It helps organizations unlock sources of value, identify points of vulnerability, and do well by doing good.

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# Revisit 2020's compendium on decisive actions to emerge stronger in the next normal

Last September, we published "[What now? Decisive actions to emerge stronger in the next normal.](#)" In case you missed it, explore the experience and dig into the ten actions we recommended at the time to reenergize your organization.

**1 Think of the return as a muscle**  
As companies return from the COVID-19 crisis, they need to exercise certain capabilities, including the willingness to change future plans and manage structural shifts. Handling the crisis is a marathon, so the emphasis should be on reinventing business models for 2021 and beyond, not so much on returning to pre-2020.

["Return: A new muscle, not just a plan"](#)

**2 Focus on high-impact actions**  
Which actions are best for the business? They will differ by company but may include technology-enabled next-generation operations, analytics-enabled engineering productivity, and automation of service-related processes.

["The COVID-19 recovery will be digital: A plan for the first 90 days"](#)

**3 Rebuild for speed**  
Getting things done fast—and well—is critical: what used to take a week now must happen in a day. That means speeding up decision making, deploying nimble teams, redeploying talent, and empowering tomorrow's leaders to take responsibility today. Cut nonpriority initiatives to free up leadership time.

["Ready, set, go: Reinventing the organization for speed in the post-COVID-19 era"](#)

["Rapid Revenue Recovery: A road map for post-COVID-19 growth"](#)

**4 Reimagine the workforce from the top down**  
Identify employee segments that may be under new forms of stress (such as parents of small children, isolated single people, and caretakers). Consider changing how work gets done, whether that's through job sharing, flex teams, or hot-seat changeovers. And continue to invest in learning.

["Adapting workplace learning in the time of coronavirus"](#)

["Reimagining the postpandemic workforce"](#)

["HR says talent is crucial for performance—and the pandemic proves it"](#)

**5 Make bold portfolio moves**  
Companies that make smart portfolio moves now will benefit disproportionately after crisis recovery. To get positioned for strong growth in 2021, shed business units that aren't part of the future growth equation and move quickly to fund new, transformational growth areas.

["A blueprint for M&A success"](#)

**6 Reset technology plans**  
Take a hard look at technology investments and reset them for value and speed. Aim to raise the technology quotient of all employees. "Cleansheet" the tech budget for 2021 rather than working off the backlog. Ensure that tech capabilities are mapped to sources of customer value.

["Building the vital skills for the future of work in operations"](#)

## 7 Rethink the global footprint

Given the vulnerability of just-in-time supply chains that the COVID-19 crisis revealed and the diminished labor-cost advantage of offshoring, companies need to take a hard look at how and where they operate. That could mean reshoring or multishoring operations and developing regional—rather than global—strategies.

[“Supply-chain recovery in coronavirus times—plan for now and the future”](#)

[“From thinking about the next normal to making it work: What to stop, start, and accelerate”](#)

## 8 Take the lead on climate and sustainability

Some pandemic-related economic-stimulus measures (such as the European Green Deal) have been linked to sustainability-related goals. Two ideas for connecting sustainability to business opportunities are to explore industry consortiums for setting new standards and creating large-scale impact and to embed sustainability into business by design rather than as an add-on.

[“Confronting climate risk”](#)

[“Addressing climate change in a postpandemic world”](#)

## 9 Think about the role of regulation and government

As governments continue to act as payers, lenders, and insurers of last resort, their reach has extended into all aspects of business. Work with them on top priorities, such as reskilling and building digital infrastructure. Develop insights on social shifts that could inform legislation and regulation.

[“‘And now win the peace’: Ten lessons from history for the next normal”](#)

[“COVID-19: Strategies for getting ahead of the pandemic crisis”](#)

## 10 Make purpose part of everything

Having a strong sense of purpose helps companies navigate uncertainty—and helps people stay engaged and productive. Now more than ever, companies must match their actions to their words. Embrace stakeholder capitalism—the idea that successful companies serve more than just the bottom line.

[“Igniting individual purpose in times of crisis”](#)

[“The CEO moment: Leadership for a new era”](#)

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