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Perspectives on retail and consumer goods

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Perspectives on retail and consumer goods is written by experts and practitioners in McKinsey & Company's Retail and Consumer Goods practices, along with other McKinsey colleagues.

To send comments or request copies, email us: McKinsey_on_Consumer@McKinsey.com

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Foreword

The past few months have been more intense than any in recent memory. As of this writing, COVID-19 remains an unresolved public-health challenge—causing tragic loss of life and serious threats to the physical and mental well-being of people everywhere, as well as immense economic damage. In addition, shocking incidents in the United States have shone a spotlight on racial bias and social injustice, and have led to a reset in values in many parts of the world.

For consumer-packaged-goods (CPG) and retail companies, the impact of these world-shaking events hasn't been uniform. Some companies have been among the hardest hit, suffering massive sales declines and laying off thousands of employees during lockdowns, whereas other companies faced unprecedented spikes in demand and had to rapidly expand their workforces. Meanwhile, trends have accelerated at a pace that, until recently, was unimaginable; changes that otherwise might have taken a decade instead happened in days. Digitization, online ordering and delivery, and remote working became widespread practically overnight.

Throughout this difficult time, we have been working side by side with many of the leading global institutions in the consumer sector. Their highest-priority topics have shifted: in March, most companies focused primarily on protecting employees' and customers' safety, managing cash, building resilience into the supply chain, and setting up control towers and "nerve centers." More recently, many companies have turned their attention to return and recovery. Business leaders are now thinking about long-term strategic moves, particularly as the "next normal" looks dramatically different than the future they had been planning for at the start of 2020.

Retailers and consumer goods manufacturers have the enormous responsibility—and opportunity—to reinvent themselves and reimagine their next normal. We have been continually inspired by the passion, speed, innovation, and sense of purpose that we've seen across various subsectors and regions. We believe, more than ever, that companies can and should learn from each other as they navigate an uncharted future.

We hope this collection of articles will serve as a guide in that journey. This compendium contains our latest thinking on the topics that matter most to retail and CPG leaders. It also features perspectives from respected business leaders Nick Vlahos, CEO of The Honest Company; Hubert Joly, executive chairman of Best Buy; and Daniel Zhang, chairman and CEO of Alibaba Group.

Consumer behavior and the business environment are changing fast—and it's critical for companies to keep a pulse on both. In addition to the pieces in this collection, we have published numerous consumer surveys, industry-focused reports, articles, and interviews since the pandemic began, and we will continue to do so. We are committed to remaining a trusted and valued partner to retailers and CPG manufacturers as the next normal unfolds.

Last, but not least, we want to thank the many consumer sector enthusiasts who made this compendium happen. Let us thank the many guest authors who made this reading so inspiring as well as all our 80+ authors who shared leading-edge thinking from across the world on all different facets of the consumer world. A special thanks also goes to Tobias Wachinger and Daniel Zipser for their thought leadership as senior members of the editorial board and to Julia Büntig, our core project manager.

For our most up-to-date insights, please visit McKinsey.com, or contact us at McKinsey_on_Consumer@McKinsey.com to join our interest group.

We hope you enjoy reading as much as we did putting it together.
Please reach out to our teams any time.

Greg Kelly
Senior partner, Atlanta

Sajal Kohli
Senior partner, Chicago

Consumer insights

Consumer sentiment is evolving as countries around the world begin to reopen

Even in countries that have partially reopened, consumer optimism remains muted and spending intent is still below pre-crisis levels.

by Nidhi Arora, Tamara Charm, Anne Grimmelt, Mianne Ortega, Kelsey Robinson, Yvonne Staack, Scott Whitehead, and Naomi Yamakawa

This article first appeared on McKinsey.com in July 2020.

Consumer behaviors are settling into a new normal, as people everywhere learn to live with the reality of COVID-19 and as more countries reopen parts of their economies. Although the pandemic's impact has varied across regions, five themes have become evident among consumers across the globe:

— Shift to value and essentials

— Flight to digital and omnichannel

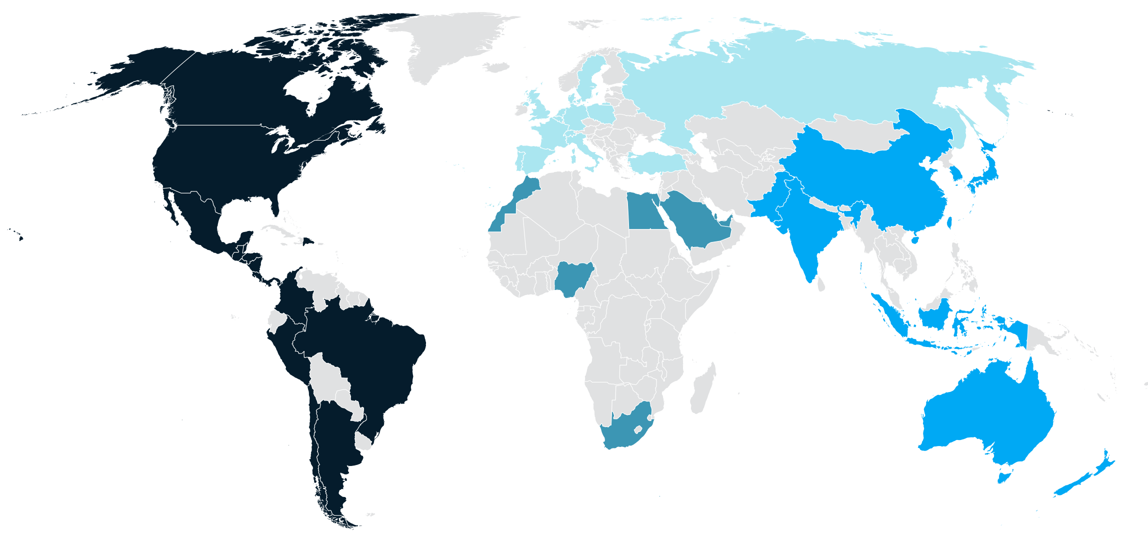
— Shock to loyalty

— Health and "caring" economy

— Homebody economy

While these themes hold true across the 45 countries we have tracked through the crisis (see sidebar, "About our surveys"), the following exhibits focus on a subset of 12 core countries, selected because of their economic significance and the impact that COVID-19 has had on their populations.

We are tracking consumer sentiment over 45 countries.



AMERICAS

Argentina, Belize, Brazil, Canada, Chile, Colombia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru, USA

ASIA-PACIFIC

Australia, China, India, Indonesia, Japan, New Zealand, Pakistan, South Korea

EUROPE

Belgium, Denmark, France, Germany, Italy, Netherlands, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, UK

AFRICA AND MIDDLE EAST

Egypt, Morocco, Nigeria, Saudi Arabia, South Africa, Qatar, United Arab Emirates

The boundaries and names shown on this map do not imply official endorsement or acceptance by McKinsey & Company.

About our surveys

Since mid-March, McKinsey has conducted consumer surveys across the globe to understand the impact of COVID-19 on consumer sentiment and stated behavior. The surveys, now fielded in 45 countries, are conducted online in local languages on a weekly, biweekly, or monthly basis, depending on the region. In each country, results are sampled and weighted for a representative balance of the consuming class, based on variables including age and socioeconomic status.

1. Shift to value and essentials

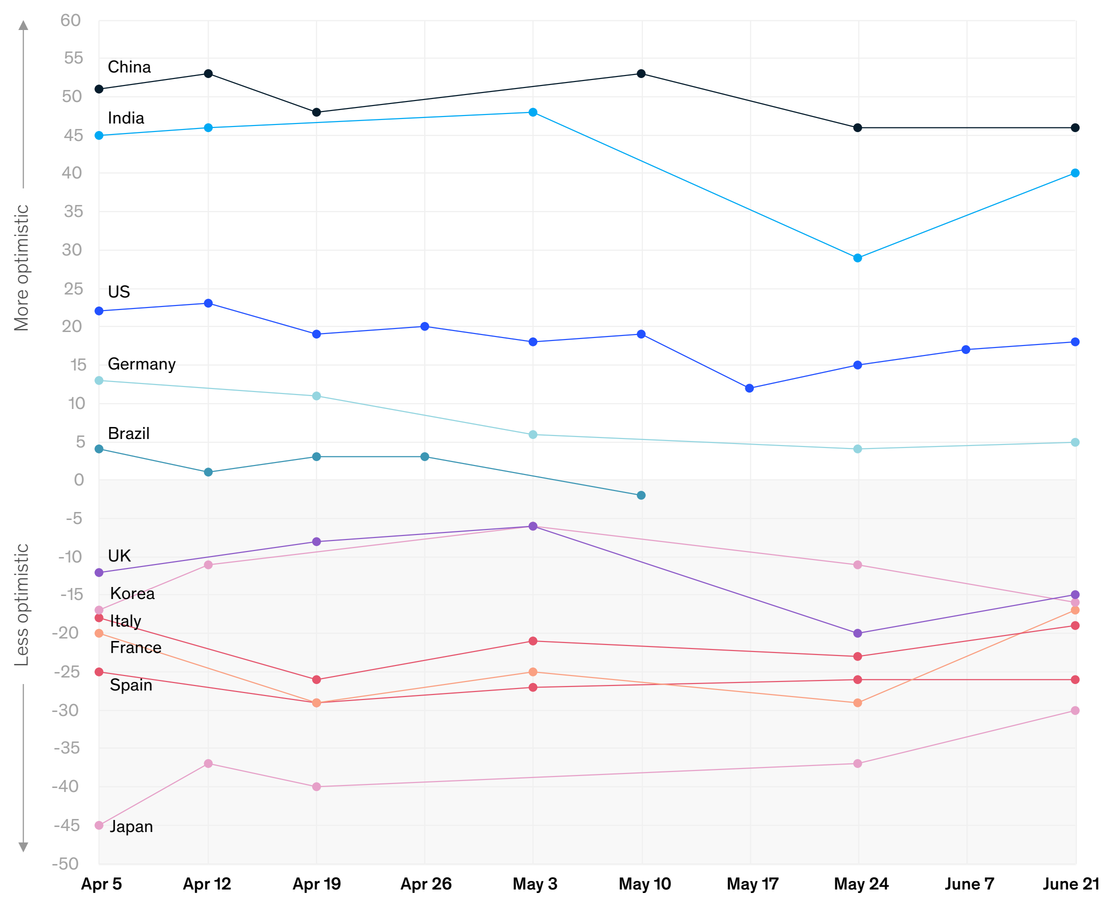
Even as some countries have reopened, many consumers globally are continuing to see their incomes fall. And they aren't feeling too optimistic about their countries' economic outlook. In most countries, confidence about economic recovery has dipped slightly since early April. Consumers in China and India remain more optimistic than their counterparts in the rest of Asia, Europe, or the United States (Exhibit 1).

Exhibit 1

Consumer sentiment varies greatly across countries impacted by COVID-19.

Optimism about country's economic recovery after COVID-19[1]

Net optimism %[2]



[1]Q: "How is your overall confidence level on economic conditions after the COVID-19 situation?" – Rated from 1 "very optimistic" to 6 "very pessimistic."

[2]Net optimism is calculated by subtracting the percentage of respondents who answered 5 "pessimistic" and 6 "very pessimistic" from the percentage of respondents who answered 1 "very optimistic" and 2 "optimistic."

Source: McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between March 15 and June 21, 2020

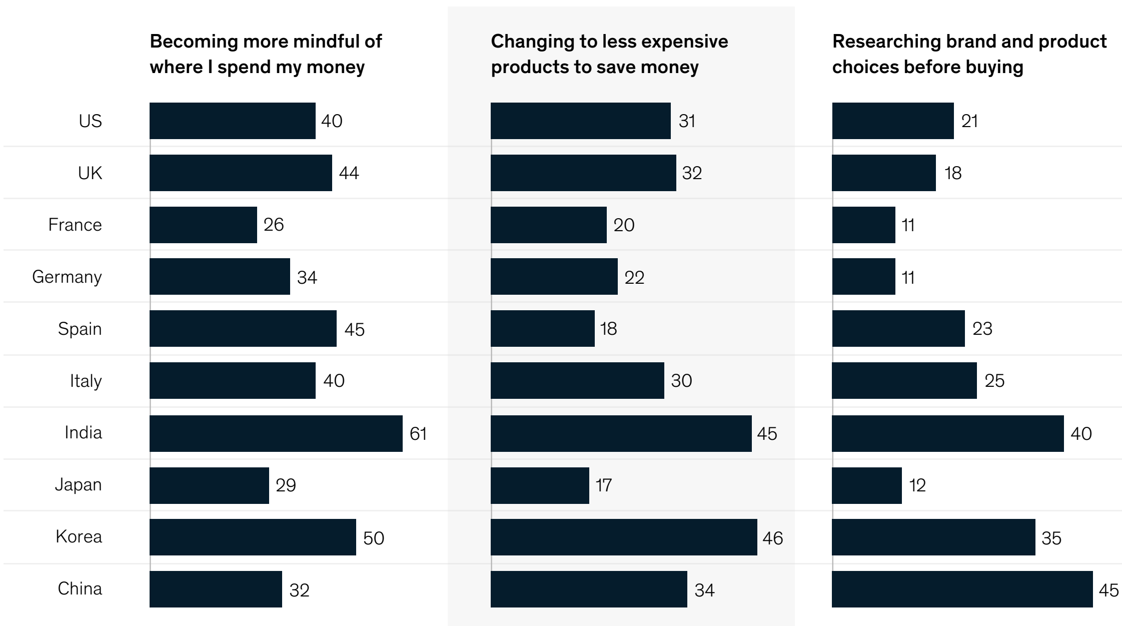
With many people expecting COVID-19 to negatively affect their finances as well as their daily routines for at least another four months, consumers are being mindful about their spending and trading down to less expensive products (Exhibit 2).

Exhibit 2

There has been a shift to mindful shopping, including some trading down for value.

Change in shopping mindset since COVID-19[1]

% of respondents who are doing more[2]



[1]Q: "Which best describes how often you are doing each of the following items?" Possible answers: "Doing less since coronavirus started"; "Doing about the same since coronavirus started"; "Doing more since coronavirus started."

[2]Percentage of respondents who answered that they are doing more since COVID-19 started.

Source: McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between June 15 and June 21, 2020

As consumers hunker down for a prolonged period of financial uncertainty, they intend to continue shifting their spending largely to essentials, such as groceries and household supplies and cutting back on most discretionary categories. While purchase intent is increasing for a large set of categories since we first measured it at the end of March, outside China it remains weak in discretionary categories such as apparel, footwear, and consumer electronics (Exhibit 3).

Consumers in China, India, and Korea are reporting positive spending intent in the next two weeks on a broader range of categories, including household supplies, personal-care products, nonfood child products, and gasoline.

Exhibit 3

Global consumers anticipate pulling back on spending across categories.

Expected spending per category over the next two weeks compared to usual[1]

Net intent %[2]

[1]Q: "Over the next two weeks, do you expect that you will spend more, about the same, or less money on these categories than usual?"

[2]Net intent is calculated by subtracting the percentage of respondents stating they expect to decrease spending from the percentage of respondents stating they expect to increase spending.

Source: McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between March 15 and June 21, 2020. Source of data for South Africa and Brazil was McKinsey & Company, COVID-19 Consumer Pulse surveys, conducted between May 15 and May 25, 2020.

2. Flight to digital and omnichannel

Most categories have seen more than 10 percent growth in their online customer base during the pandemic (Exhibit 4), and many consumers say they plan to continue shopping online even when brick-and-mortar stores reopen. In markets that had moderate online conversion rates before the pandemic, such as the United Kingdom and the United States, e-commerce continues to grow across all product categories. In markets like China with a high rate of online shopping before the pandemic, although total consumer participation in online shopping is not expected to go up substantially, the share of wallet spent online is expected to increase.

Exhibit 4

A majority of respondents expect to shop online more after COVID-19 than they did before.

Customers purchasing category online[1]

% growth[2]

[1]Q: "Before the coronavirus (COVID-19) situation started, what proportion of your purchases in this category were online vs from a physical store/in person?" Possible answers: "Didn't purchase online"; "Some online"; "Most online"; "All online." Q: "Once the coronavirus (COVID-19) situation has subsided, tell us what proportion of your purchases in this category you think will be online vs from a physical store/in person." Possible answers: "Didn't purchase online"; "Some online"; "Most online"; "All online."

[2]Percent growth is calculated by subtracting the pre-COVID-19 percentages from post-COVID-19 percentages and dividing by pre-COVID-19 percentages of respondents selecting "Some online"; "Most online"; "All online."

Source: McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between June 15 and June 21, 2020

In addition to e-commerce, other digital and contactless services—including curbside pickup, delivery, and drive-through service—are also seeing much higher adoption rates. While some of these habits are seen as a work-around to the crisis, many at-home solutions to regular activities will likely be adopted for the long term.

3. Shock to loyalty

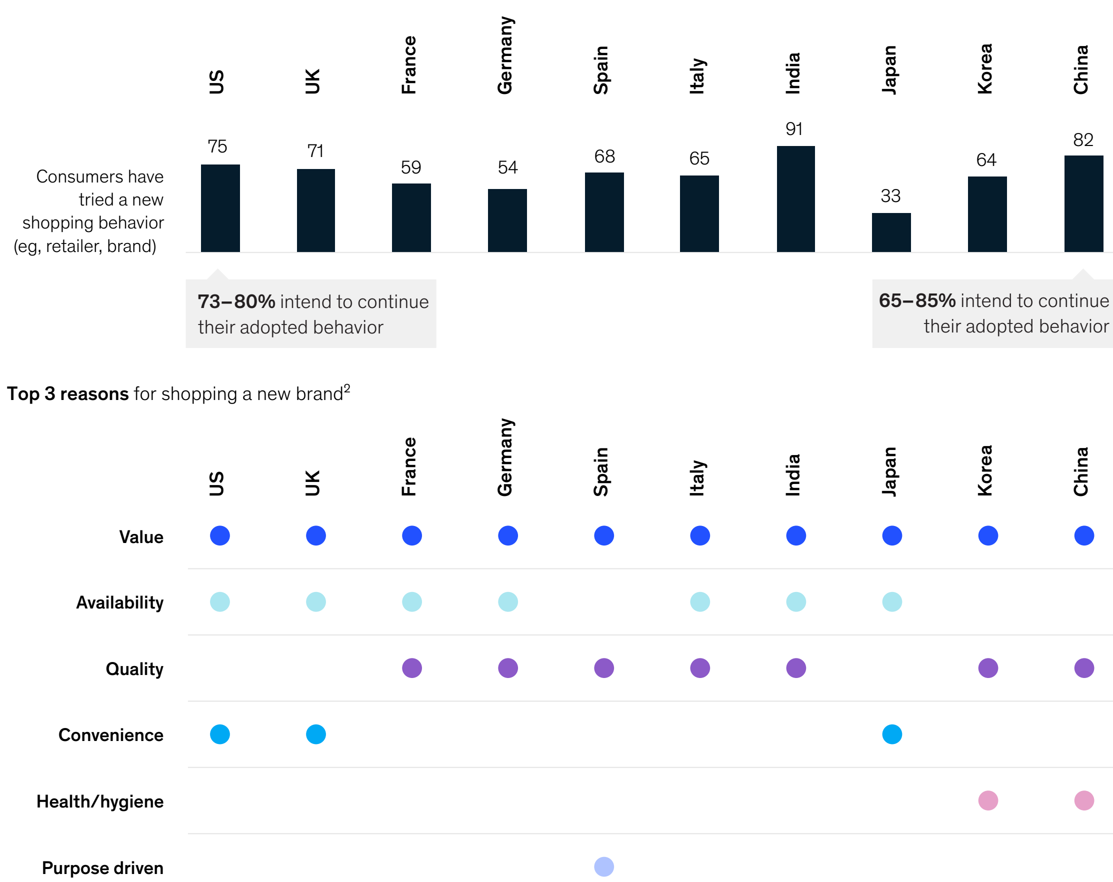
For certain products and brands, COVID-19 caused supply-chain disruptions. And when consumers couldn't find their preferred product at their preferred retailer, they changed their shopping behavior: many consumers have tried a different brand or shopped at a different retailer during the crisis. Value, availability, and quality were the main drivers for consumers trying a different brand (Exhibit 5).

Our research shows that in China and the United States, 75 percent or more of consumers reported trying a new shopping method, while in Japan, where lockdowns weren't imposed, the comparative number is only 33 percent. We expect these changes will shape consumers' habits even beyond the effects of COVID-19. In China and the United States, at least 65 percent of consumers who tried a new behavior plan to stick with it postcrisis.

Exhibit 5

Over 60 percent of global consumers have changed shopping behavior, many of them for convenience and value.

Customers who have tried new shopping behaviors since COVID-19[1]
% of respondents



[1]Q: "Since the coronavirus (COVID-19) situation started (ie, in the past ~3 months), which of the following have you done?"
[2]Q: "You mentioned you tried a new/different brand than what you normally buy. What was the main reason that drove this decision? Select up to 3." Brand includes different brand, new private-label/store brand.

Source: McKinsey & Company, COVID-19 Consumer Pulse surveys, conducted globally between June 15 and June 21, 2020

4. Health and ‘caring’ economy

Across countries, survey respondents say that when deciding where to shop, they look for retailers with visible safety measures such as enhanced cleaning and physical barriers. In addition, they buy more from companies and brands that have healthy and hygienic packaging and demonstrate care and concern for employees (Exhibit 6).

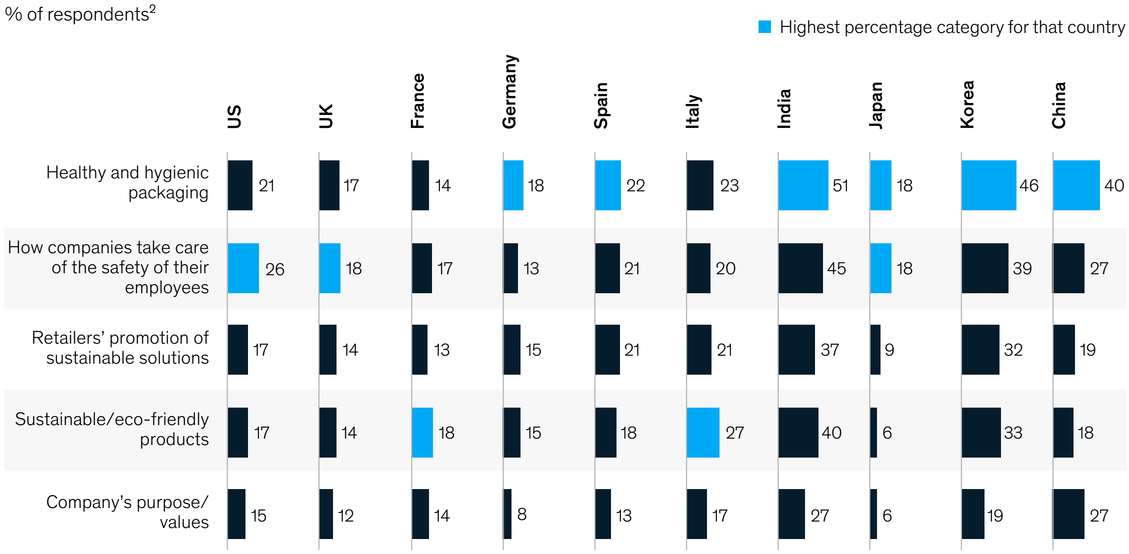
During these trying times, consumers have a heightened awareness of how businesses interact with stakeholders, local communities, and society more broadly. The actions that businesses take during this pandemic are likely to be remembered long after COVID-19 has been conquered.

Exhibit 6

Consumers are more concerned than they used to be about healthy and hygienic packaging and how companies treat their employees.

Consumers buying more based on company behavior[1]

% of respondents[2]



[1]Q: “Which best describes how often you are doing each of the following items?” Possible answers: “Doing less since coronavirus started”; “Doing about the same since coronavirus started”; “Doing more since coronavirus started.”

[2]Percentage of respondents who responded “doing more since coronavirus started.”

Source: McKinsey & Company COVID-19 Consumer Pulse surveys, conducted globally between June 15 and June 21, 2020

The actions that businesses take during this pandemic are likely to be remembered long after COVID-19 has been conquered.

5. Homebody economy

In most countries, more than 70 percent of survey respondents don't yet feel comfortable resuming their "normal" out-of-home activities. For more than three-quarters of consumers who adjusted their behaviors due to the health crisis, the easing of government restrictions won't be enough. Instead, they'll wait for guidance from medical authorities, reassurance that safety measures are in place, and the development of a COVID-19 vaccine and/or treatments.

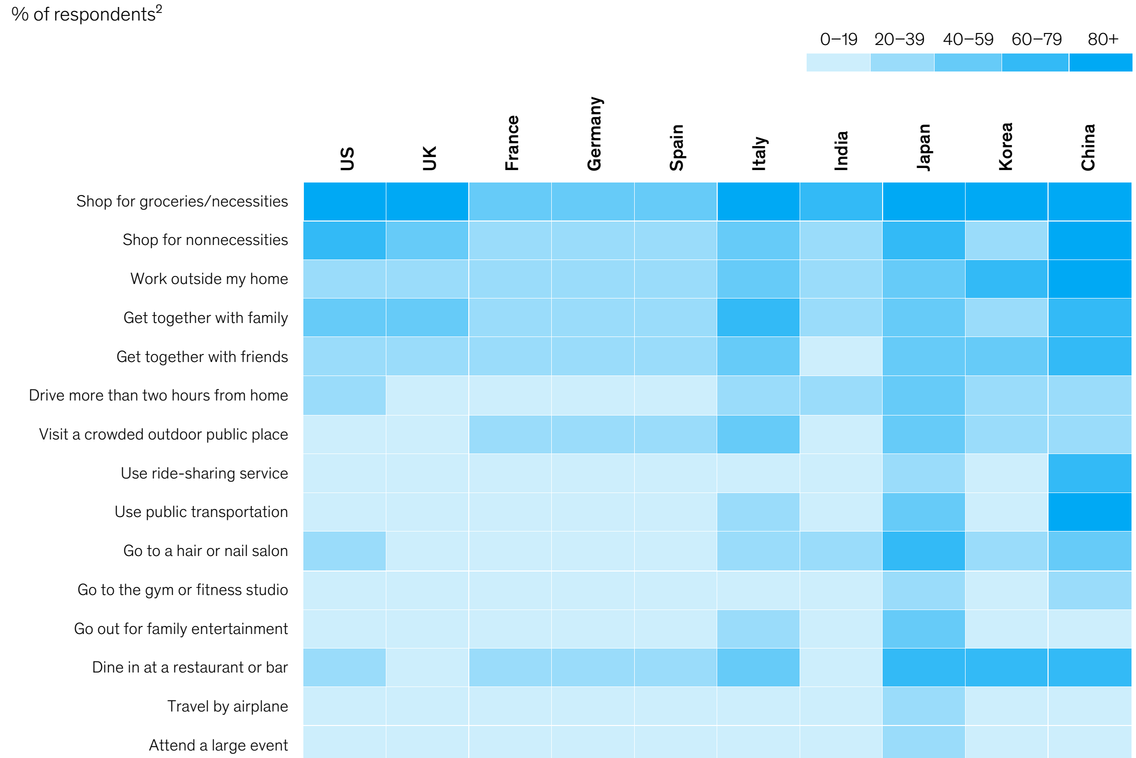
Consumers do plan to resume some of their out-of-home activities soon, and shopping is first on the list. Large events and air travel, on the other hand, are last on the list (Exhibit 7).

Exhibit 7

Intent to pursue out-of-home activities varies by category and country.

Intended engagement with activities outside home for the next two weeks[1]

% of respondents[2]



[1]Q: "Which of the following activities do you intend to leave your home to do in the next two weeks?"
[2]Chart represents percentage of respondents who intend to leave their home to do this activity during the next two weeks.

We will continue to track consumer sentiment to gauge how people's expectations, perceptions, and behaviors change throughout the crisis. In addition to the exhibits embedded here, please see the country-level survey data, which will be updated regularly.

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How COVID-19 is changing consumer behavior—now and forever

by Victor Fabius, Sajal Kohli, Sofia Moulvad Veranen, and Björn Timelin

As the world begins its slow pivot from managing the COVID-19 crisis to recovery and the reopening of economies, it's clear that the period of lockdown has had a profound impact on how people live.

The period of contagion, self-isolation, and economic uncertainty will change the way consumers behave, in some cases for years to come.

The new consumer behaviors span all areas of life, from how we work to how we shop to how we entertain ourselves. These rapid shifts have important implications for retailers and consumer-packaged-goods companies.

Many of the longer-term changes in consumer behavior are still in flux, giving companies an opportunity to help shape the next normal.

1. COVID-19 is transforming consumer lives: we have covered a 'decade in days' in adoption of digital

Three change forces: economic downturn, preference shifts, and digital acceleration

2. Behavior changes are not linear, and their stickiness will depend on satisfaction with the new experiences

Ups and downs ahead of us

Stickiness = forced behavior x satisfaction

The jury is still out on value-driven behaviors

3. The future is now: players should prepare

Prepare for consumption declines or trading down

Address footprint offer and shopping experience for the new reality

Follow consumers in their new decision journeys when marketing and communicating

COVID-19 is changing how consumers behave across all spheres of life

We see new behaviors emerging across 8 areas of life (eg, surge in e-commerce, changing of brand preferences, higher unemployment)

Work

Rise of unemployment

On-the-go consumption decline

Remote working

"20x increase in Zoom daily participants"

Source: Bond Capital

Shopping and consumption

Surge in e-commerce

Preference for trusted brands

Decline in discretionary spending, trading down

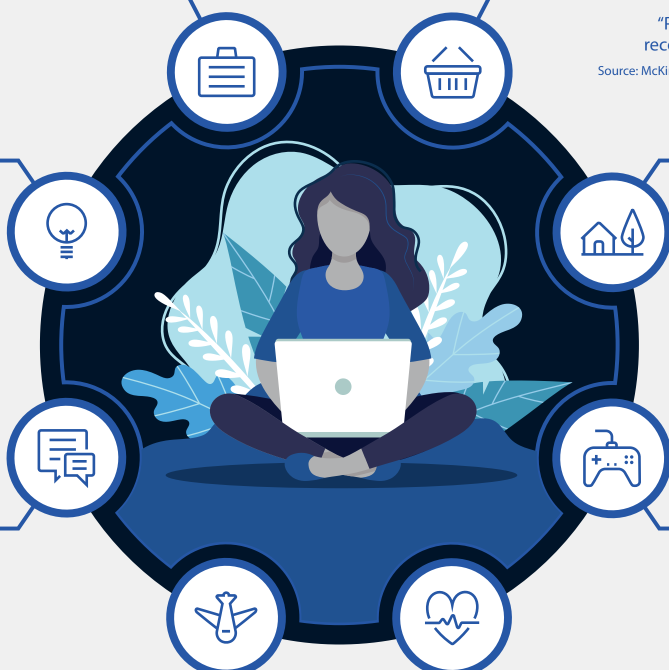
Larger basket, reduced shopping frequency

Shift to stores closer to home

Polarization of sustainability

"Personal disposable income is not expected to recover to pre-crisis level until Q2 2024 in the US"

Source: McKinsey analysis in partnership with Oxford Economics, Scenario A1



Learning

Spending on learning adjacencies

Remote learning

"~35% of Netflix subscribers use it for educational content"

Source: YouGov

Life at home

Nesting at home

Surge in online

"Home is recast as the new coffee shop, restaurant, and entertainment center"

Communication and information

In-person sampling decline

Shift in media consumption

"Further migration to digital"

Play and entertainment

Preference for digital entertainment

Entertainment channel shift (eg, cinema to streaming)

Additional play time

"Disney+ achieved in 5 months what took 7 years for Netflix"

Source: Phone Arena

Travel and mobility

Reduction in tourist spend and travel retail

Increase in domestic tourism

"80% reduction in international travel and related tourist spend"

Source: McKinsey analysis in partnership with Oxford Economics

Health and well-being

Focus on health and hygiene

Acceleration of organic, natural, fresh

Fitness on demand

E-pharmacy and e-doctor at scale

"Monthly year-over-year growth of organic produce in the US increased by 10x in March compared with January and February"

Source: Organic Produce Network

Many of the trends are accelerations of past behaviors

We have covered a "decade in days" when it comes to adoption of digital

Online delivery

10 years in 8 weeks

For increase in e-commerce deliveries

Telemedicine

10x in 15 days

Remote working

20x participants

on videoconferencing in 3 months

Remote learning

250 million in 2 weeks

students who went online in China

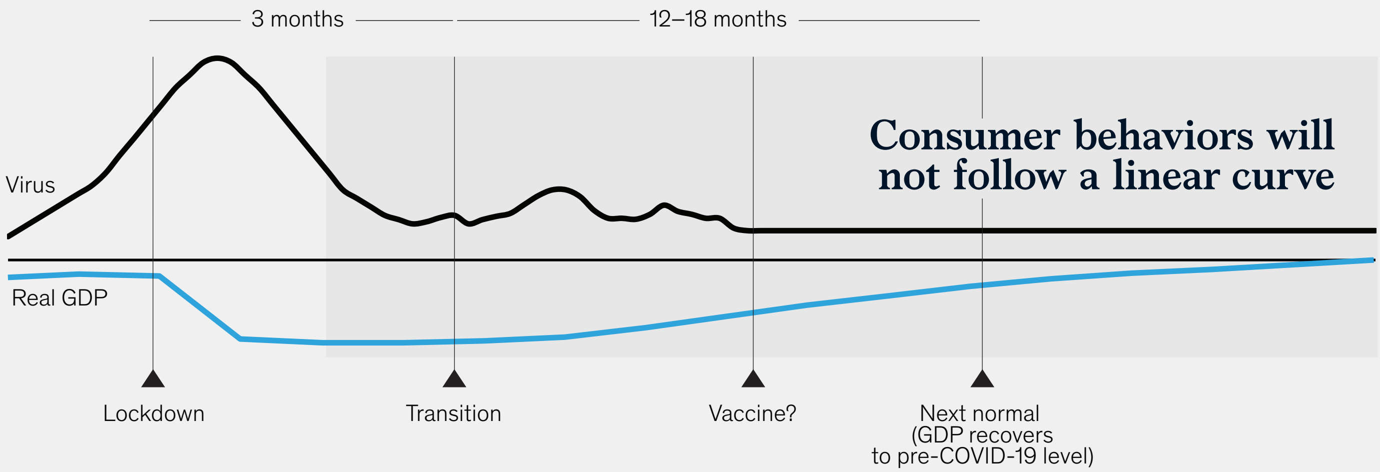
Online entertainment

7 years in 5 months

Disney+ acheived in 5 months what took Netflix 7 years

Most behaviors will see a linear development trend or stick in the next normal

As countries gradually lift restrictions, one more phase remains before we reach the next normal



Stickiness = forced behavior [including duration] x satisfaction

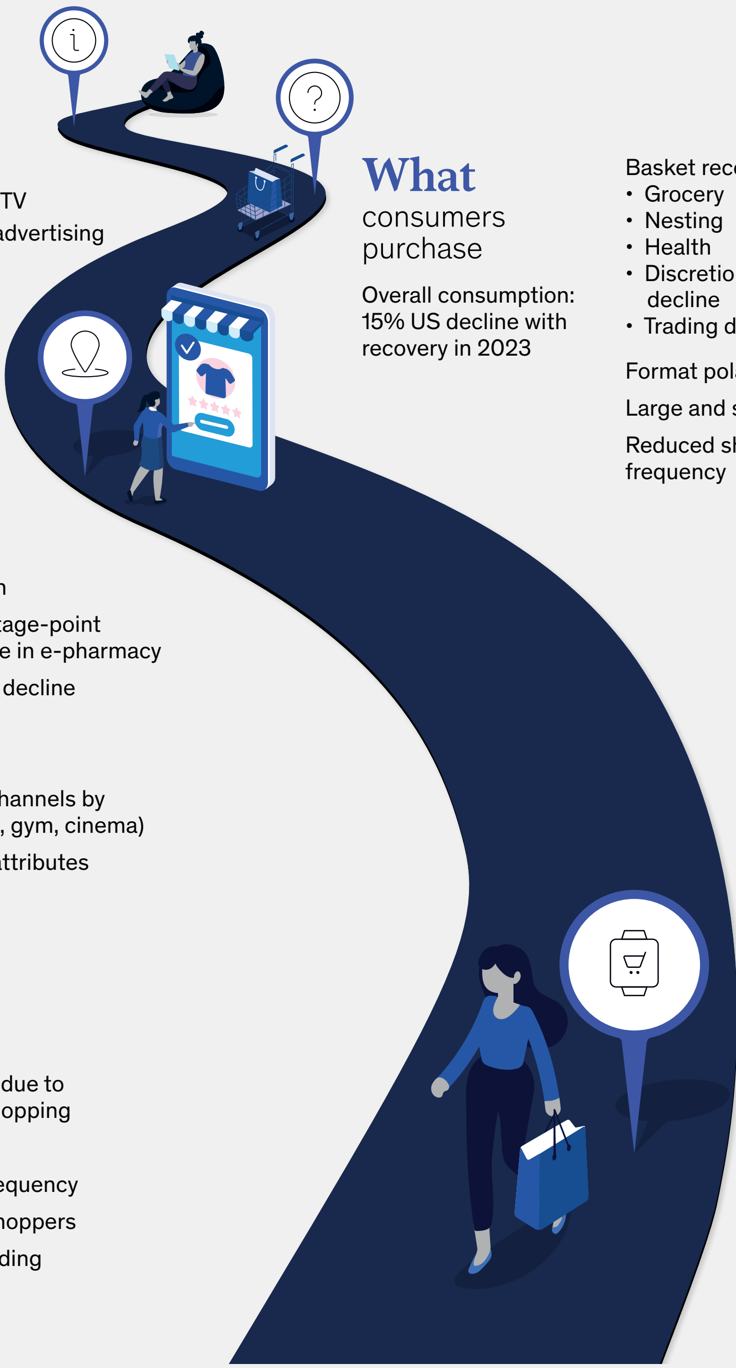
Our hypotheses on which changes could stick or dissipate

New trend · Discontinuity · Acceleration · Unknown

	Probably temporary		Enduring
Decline in consumption		Reduction in international travel retail; Increase in domestic tourism	Trading down and price sensitivity; Reduction in discretionary spending
Shake-up of preferences	Reduction in on-the-go consumption; Larger basket	Preference for trusted brands; Polarization of sustainability; Nesting at home	Focus on health and hygiene
Digital acceleration	Preference for digital entertainment		Remote working; Surge in e-commerce; Rise of e-pharmacy and e-doctor; Fitness on demand at scale; Entertainment-channel shift from physical to digital

Behavior changes will reshape consumer decision journeys, and companies will need to adapt fast

Retailers and consumer-packaged-goods companies that use the transition period to rethink consumer-decision journeys can reshape consumer behavior



How
consumers
get information

Shake-up of media mix: further shift to digital

Temporary comeback of TV

Decline in out-of-home advertising

Decline in in-person engagement

What
consumers
purchase

Overall consumption: 15% US decline with recovery in 2023

Basket recomposition
- Grocery
- Nesting
- Health
- Discretionary spend decline
- Trading down

Format polarization

Large and small packs

Reduced shopping frequency

Shake-up in hierarchy of needs

Health and hygiene rises

Polarization of sustainability

Brand-preference evaluation

Turning to A brands for trust

Where
consumers
purchase

Channel mix reevaluation

E-commerce: 17-percentage-point increase in grocery, surge in e-pharmacy

On-the-go consumption decline

Decrease in travel retail

Replacement of offline channels by at-home alternatives (eg, gym, cinema)

New channel-selection attributes

Proximity to home

Hygiene

No queue/room in store

New shopping reality

Decrease in satisfaction due to inconvenience of safe shopping

Increase in basket size

Decrease in shopping frequency

Decrease in density of shoppers

Decrease in tourist spending

How
consumers
experience

Shake-up in what consumers value

Loyalty shake-up, as consumers are forced to try new things

Retailers will face challenges across multiple dimensions

Sales

- Reinvent shopping experience: hassle-free shopping in high-hygiene environment; change store layouts and proposition, reconfigure checkout, offer longer operating hours, provide omnichannel
- Right-size network to recognize 15% drop in consumption
- Leapfrog digital capabilities toward first-class e-commerce, seamless omnichannel experience; consider drive-through, click-and-collect
- Reevaluate physical-store footprint, as traffic from professionals and tourists declines and affects travel retail and on-the-go consumption

Marketing

- Consumers have changed where and how they engage, and marketing spending should reflect this
- Stay relevant across multiple touchpoints (brand.com, platforms, e-retailers, own stores, multibrand stores)
- Allocate resources in line with journey shifts; eg, increase digital engagement (social, influencers, D2C) away from out-of-home advertising, print, trade marketing
- Win in loyalty shifts: ensure first-class customer-relationship-management system, foster trust through communication, and provide incentives for first-time shoppers

Assortment

- Reimagine value for money: price, private label, quality, branding, merchandising
- Capture new needs: health, safety, fresh, new ready to eat; reduce exposure to highly discretionary categories
- Adapt formats to new needs: polarization in pack size (large and single packs) and hygiene certainty
- Rethink brand mix: increase exposure to post-COVID-19 loyalty-shift winners (trusted A brands and local brands), and simplify assortment

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The authors wish to thank Christoffer Breum, Marco Catena, Becca Coggins, Jörn Küpper, Simona Kulakauskaite, Luiz Lima, Jaana Remes, Kelsey Robinson, Hamid Samandari, Raghavendra Uthpala, and Naomi Yamakawa for their contributions to this article.

The great consumer migration: How US shopping behavior is changing

The results from our US-specific consumer sentiment survey reveal what matters to consumers as the COVID-19 crisis progresses.

by Tamara Charm, Becca Coggins, Kelsey Robinson, and Jamie Wilkie

Anyone who has hosted a virtual game night or had their third lunch this week delivered grasps how profoundly the COVID-19 crisis has changed our behavior. But will these changes stick? Our global findings show five megatrends: flight to online, shock to loyalty, need for hygiene transparency, back to basics and value, and the rise of the homebody economy.[1]

In this country-specific deep dive, we examine key behavior trends and the corresponding consumer segments in the United States.[2]

Flight to online

1. Digital shopping is here to stay

Physical distancing and stay-at-home orders have forced whole consumer segments to shop differently. A few months into COVID-19, consumer shopping online has increased significantly across many categories. Consumer intent to shop online continues to increase, especially in essentials and home-entertainment categories. What's more, these habits seem likely to stick as US consumers report an intent to shop online even after the COVID-19 crisis. Categories where expected growth in online shoppers exceeds 35 percent include essentials such as over-the-counter medicine, groceries, household supplies, and personal-care products. Even discretionary categories such as skin care/makeup, apparel, and jewelry and accessories show expected online customer growth of more than 15 percent.

2. Millennials and high-income earners are in the lead when it comes to shopping online

While the shift to online shopping has been near universal across categories, high-income earners and millennials are leading the way in shifting spend online across both essential and nonessential items. Generation X has experienced a similar online shift, although not at the same scale as millennials. Generation Z has concentrated its shift online in particular categories: apparel and footwear, at-home entertainment, and food takeout/delivery.

Shock to loyalty

3. Consumers are switching brands at unprecedented rates

The crisis has prompted a surge of new activities, with an astonishing 75 percent of US consumers trying a new shopping behavior in response to economic pressures, store closings, and changing priorities. This general change in behavior has also been reflected in a shattering of brand loyalties, with 36 percent of consumers trying a new product brand and 25 percent incorporating a new private-label brand. Of consumers who have tried different brands, 73 percent intend to continue to incorporate the new brands into their routine. Generation Z and high earners are most prone to switching brands.

The beneficiaries of this shift include big, trusted brands, which are seeing 50 percent growth during the crisis, and private labels, which have outpaced the retail market. Some 80 percent of customers who started using a private brand during the pandemic indicate they intend to continue using it once the COVID-19 crisis is over.

4. Brands need to assure strong availability and also convey value

Shoppers have cited a number of reasons for switching brands, with availability (in-store and online), convenience, and value leading the pack.

For marketers, this highlights the need to find out when shoppers are migrating brands or retailers and then to manage logistics to ensure product and service availability. In China, which is further along the recovery cycle than most countries, the increase in promotional activity to cater to consumers' focus on value in apparel is expected to continue.

Need for hygiene transparency

5. US consumers are changing how they shop in response to health and safety concerns

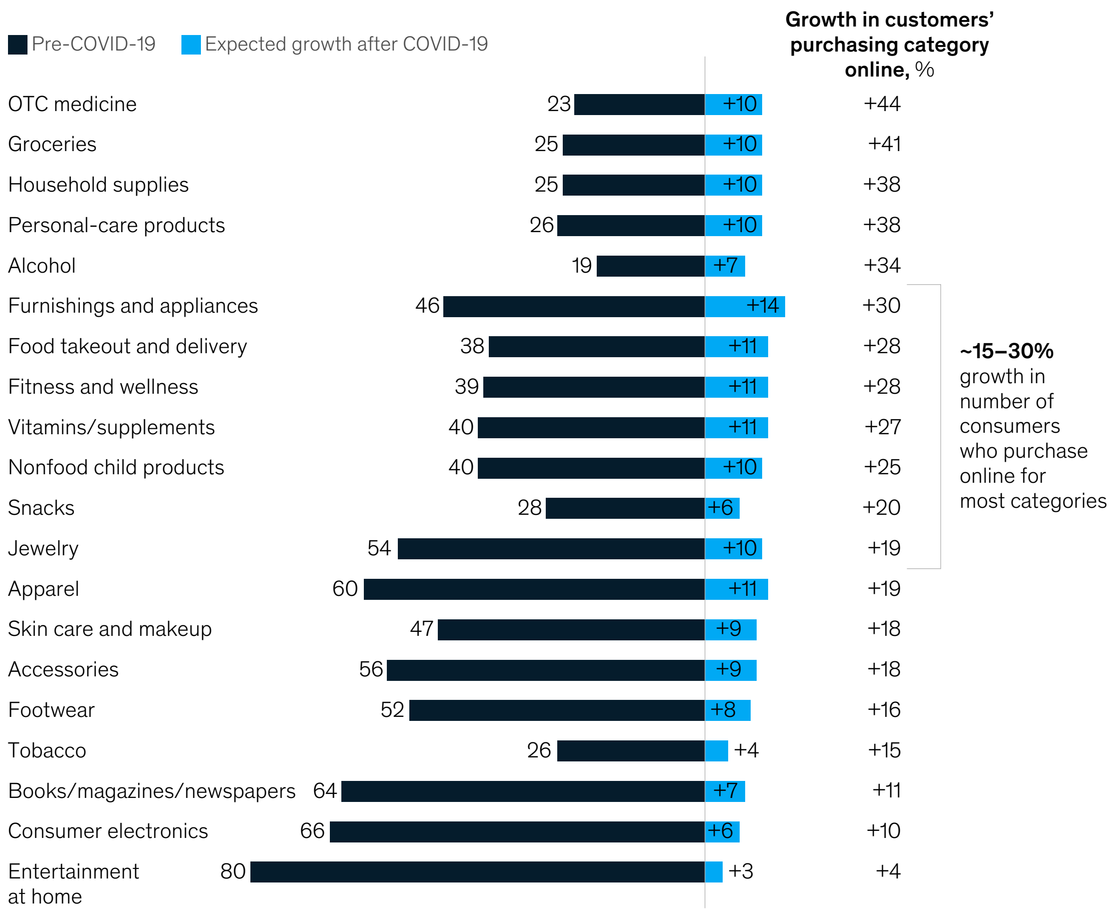
As Americans contemplate going back out to shop, hygiene and hygiene transparency have emerged as important sources of concern. It is becoming

[1] See "Consumer sentiment is evolving as countries around the world begin to reopen," the full global report on which this article is based, also in this issue.
[2] Other country-specific deep dives can be accessed in our collection "Global surveys of consumer sentiment during the coronavirus crisis" on McKinsey.com.

Exhibit 1

More people expect to make a portion of their purchases online post-COVID-19 than before.

Consumers' use of online channels before and expected use after COVID-19,[1,2]
% of respondents purchasing online[3]



[1]Q: "Before the coronavirus (COVID-19) situation started, what proportion of your purchases in this category were online vs from a physical store/in person?"
[2]Q: "Once the coronavirus (COVID-19) situation has subsided, tell us what proportion of your purchases in this category you think will be online vs from a physical store/in person."
[3]Respondents who indicated that they have not bought the category online and do not intend to do so in the next two weeks are classified as not purchasing online.
Source: McKinsey & Company COVID-19 US Consumer Pulse Survey, June 15 to June 21, 2020, n = 2,006, sampled and weighted to match the US general population 18+ years

increasingly important for stores and restaurants to not only follow hygiene protocols (thorough cleaning and masks for consumers and employees are top priorities) but also to communicate effectively that they are following those procedures.

US consumers have already started to change their behavior in response to hygiene concerns. Technologies that enhance hygiene, particularly contactless activities such as food and grocery delivery and curbside pickup, are taking off. There is strong intent to continue contactless activities across the United States. As an example, 79 percent of consumers intend to continue or increase their usage of self-checkout in retail after COVID-19. Millennials and Generation Z are the widest adopters of contactless activities.

Back to basics and value

6. Consumer shopping intent is focused on essentials

Around 40 percent of US consumers have reduced spending in general, and they expect to continue to cut back on nonessentials specifically. This reality reflects profound discomfort about the state of the economy.

With overall consumer spending declining, intent to spend in essential categories is increasing. Even among those with higher incomes, we see that while essentials show spending momentum, intent to buy discretionary products still lags significantly. As the worst of the crisis abates, we do see online spending in nonessential categories such as apparel and footwear starting to come back. This effect is strongest among high-income earners, those in the Northeast, and Gen Zers.

7. Consumers want value for their money—especially in essential categories

Tied to the concern about the state of the economy is an increasing consumer focus on value—

Exhibit 2

Spending intent for essentials, including groceries and snacks, is stronger among higher-income consumers.

Expected spending per category over the next two weeks compared to usual,[1]
net intent by annual household income

Net Intent[2] <–20 | –20 | –10 | 1 | 10 | 20+

		<$50K	$50–$100K	>$100K
Essential	Groceries	8	15	22
	Household supplies	–2	2	9
	Personal-care products	–6	–2	1
	Takeout/delivery	–13	–4	6
	Snacks	–8	0	6
	Nonfood child products	N/A[3]	–14	4
	Quick-service restaurants	–25	–18	–16
	Restaurants	–33	–27	–30
	Skin care and makeup	–27	–25	–6
	Apparel	–36	–27	–22
	Footwear	–39	–30	–16
	Furnishings and appliances	–43	–39	–18
	Jewelry	–46	–39	–22
Nonessential	Accessories	–39	–39	–23

Retailers will need to accelerate use of advanced analytics in assortment to anticipate changes in consumer trends.

CPG players will need to enhance speed to market/product development, with a focus on essential and value offerings.

[1]Q: "Over the next two weeks, do you expect that you will spend more, about the same, or less money on these categories than usual?" Figures may not sum to 100% because of rounding.
[2]Net intent is calculated by subtracting the percentage of respondents who expect to decrease spending from the percentage of respondents who expect to increase spending.
[3]Insufficient sample (<75).
Source: McKinsey & Company COVID-19 US Consumer Pulse Survey, June 15–21, 2020, n = 2,006, and June 1–7, 2020, n = 1,966, sampled and weighted to match the US general population 18+ years

especially in essential categories. For example, in shampoo on Amazon, value and mass products have experienced the greatest increase in share, with gains of two and five percentage points, respectively. In comparison, premium shampoo products have lost more than five points in volume.

Rise of the homebody economy

8. Americans are changing how they spend their time at home

Americans are spending more of their at-home time on domestic activities, media, and news. Intent to eat more at home post-COVID-19 has strengthened significantly over the past three months. Usage of popular online entertainment platforms has skyrocketed. (The popular video game Fortnite recently hosted a concert that was "attended" by 12.3 million users.[3]) Investment in at-home fitness through equipment purchases and online activity is growing. Consumers still expect to spend more time on at-home activities, even in less restricted geographies.

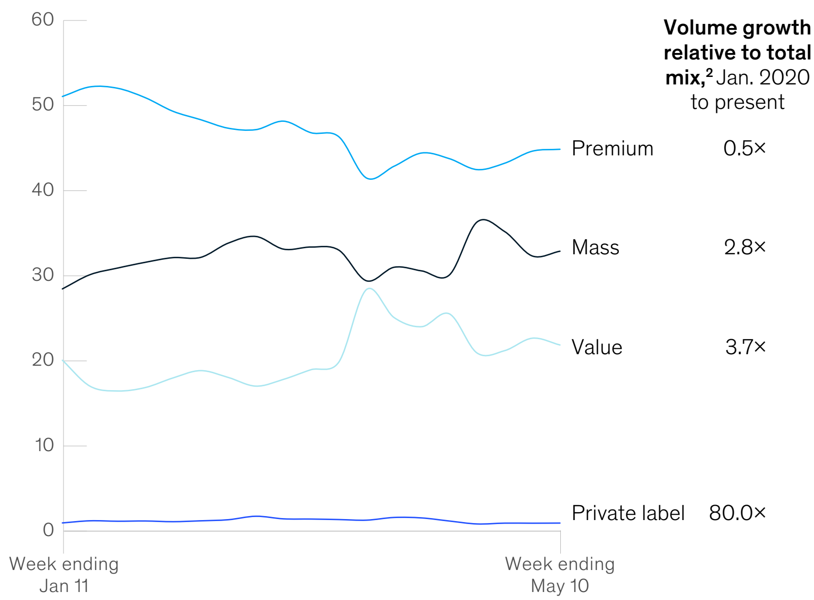
As retailers contemplate the changes in consumer behavior, they will need to adjust their strategies and execution to adapt to the new norms, including:

— adjusting mix and spend to where the consumer is now (go digital, ensure full coverage of bottom-funnel marketing and demand capture, think geo-by-geo)

Exhibit 3

Specifically in shampoo, consumers are switching to value and mass options online.

Change in share,[1] % total volume in units



Weighted average price per ounce across all tiers was $0.91 in January, rising to $0.95 in May for a 4% increase year to date[3]

Value experienced the greatest increase in price to drive this change

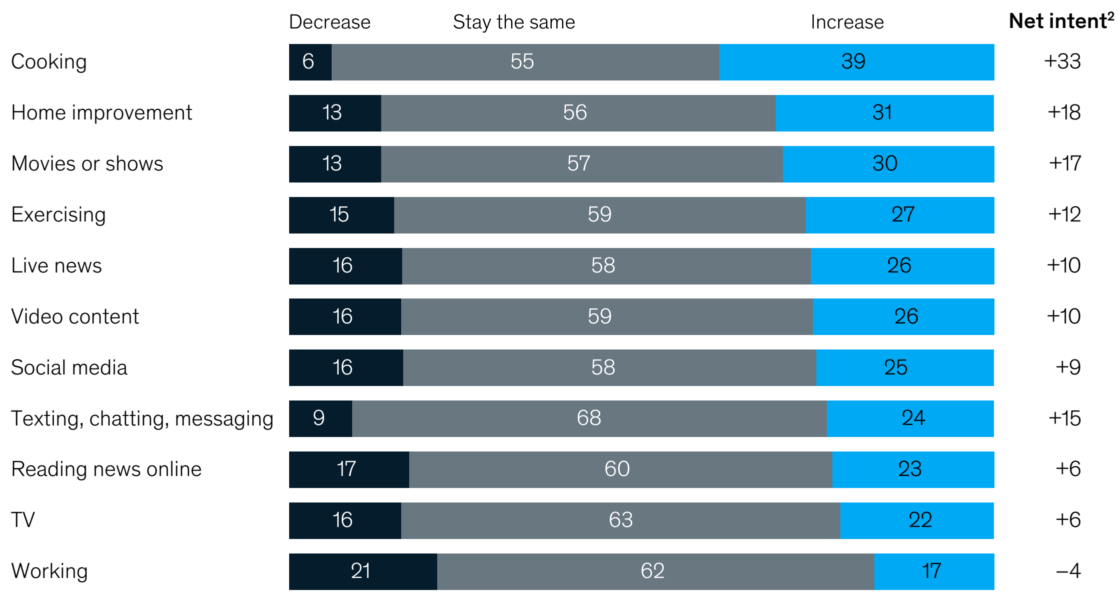
[1]Calculated based on total ounces of shampoo sold per category, taking into account both pack size and container volume.
[2]Calculated as total ounces sold week ending May 11, 2020, compared to total ounces week ending January 4, 2020.
[3]Calculated as total price per ounce week ending May 11, 2020, compared to total price per ounce week ending January 4, 2020.
Source: Slackline; pulled May 27, 2020

[3]Andrew Webster, "More than 12 million people attended Travis Scott's Fortnite concert," *Verge*, April 23, 2020, theverge.com.

Exhibit 4

Americans are changing how they spend their time, dedicating more time to domestic activities, media, and news.

Expected change to time allocation over the next two weeks,[1] % of respondents



[1]Q: "Over the next two weeks, how much time do you expect to spend on these activities compared to how much time you normally spend on them?" Figures may not sum to 100% because of rounding.
[2]Net intent is calculated by subtracting the percentage of respondents stating they expect to decrease time spent from the percentage of respondents stating they expect to increase time spent.
Source: McKinsey & Company COVID-19 US Consumer Pulse Survey, June 1–7, 2020

— revamping messaging and creative to be in sync with the times, particularly in terms of hygiene and value

— ensuring the end-to-end journey meets the new hygiene and at-home needs

— managing corporate social-responsibility efforts to build brand strength authentically

— refocusing on online and pickup solutions and rebuilding real-time measurement plans as traditional media-mix models won't suffice

Further, it will be important for brands to reevaluate and reprioritize their target audiences and consumer segments, as the emphasis on each of the next-normal trends will vary based on the target consumer.

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What makes Asia–Pacific's Generation Z different?

Gen Zers in the Asia–Pacific region aren't like their older siblings. Here is what you need to know.

by Aimee Kim, Paul McInerney, Thomas Rüdiger Smith, and Naomi Yamakawa

This article first appeared on McKinsey.com in June 2020.

Gen Zers (born 1996–2012) are coming of age. By 2025, the group will make up a quarter of the Asia–Pacific (APAC) region's population—the same as millennials (born 1980–1995). And as Gen Zers mature, they will make and spend more money. Although Gen Zers share many qualities with millennials, it's wrong to think of them simply as a younger version. Generation Z has its own unique characteristics. For one thing, unlike millennials, Gen Zers are entering into adulthood during a global pandemic. Still, the demographics are clear: by 2025, the two cohorts will compose half of APAC consumers.

In an effort to understand the distinctive ways that Gen Zers research, consider, purchase, and use products, in the second half of 2019 McKinsey surveyed more than 16,000 consumers in six countries—Australia, China, Indonesia, Japan, South Korea, and Thailand.[1] Then we compared results across three generations—Gen Zers, millennials, and Gen Xers (born 1965–1979). The survey asked respondents about their general attitudes toward brands, shopping, digital, and media, as well as their outlook on the world. It also asked specific questions about shopping habits and brands for selected categories (Exhibit 1).

In this article, we describe the consumer trends that are shaping the behavior of Gen Zers, the six broad segments that describe them, and how companies can reach them.

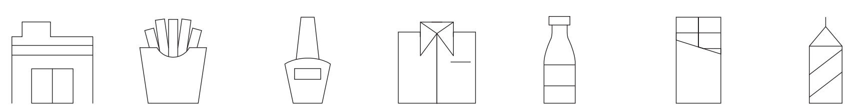
Gen Zers in APAC: Five consumer trends

Obviously, there are massive differences among the six surveyed countries in their population profile (aging Japan versus more youthful Indonesia), economics (Australia's GDP per head is several times that of Thailand), and history and culture. In specific areas, China shows tendencies that set it

Exhibit 1

The research on Generation Z consumers considered six countries and seven categories.

Industries mentioned by country



	Grocery	QSR[1]	Skin care	Apparel	Beverages	Confectionary and snacks	Dairy
Australia	●	●	●	●	●	●	
China	●	●	●	●			●
Indonesia	●	●	●				●
Japan	●	●	●	●	●	●	
South Korea	●	●	●	●	●	●	
Thailand	●				●		

Themes ● Attitudes and behaviors in shopping and consumption ● Attitudes and behaviors in food ● Digital use ● Financial outlook ● Personal lifestyle

[1]Quick service restaurant.
Source: McKinsey Asia–Pacific Generation Z Survey, November 2019, n = 16,000

[1] About 3,000 Generation Z consumers responded in each country except Thailand, where there were around 1,000 respondents.

Across APAC, almost a third of Gen Zers spend six hours or longer a day on their phones, a considerably higher share than millennials (22 percent) and Gen Xers (10 percent).

apart. Nevertheless, we were able to come to five broad conclusions about APAC's Gen Zers:

- They rely on social media but are thoughtful about how they engage with it.
- They want it all—and are used to getting it.
- They prefer brands that show their personality and uniqueness but that are also well known enough to be recognized.
- They are greatly influenced in their brand selection by video content.
- They want to be seen as environmentally conscious, but they often don't want to pay for this.

They rely on social media but are thoughtful about how they engage with it

Gen Xers, millennials, and Gen Zers are all comfortable with the digital world and rely on it for learning, shopping, and entertainment. Even in this context, Gen Zers stand out, which makes sense: they have never known a world without the internet and have grown up with social media. Across APAC, almost a third of Gen Zers spend six hours or longer a day on their phones, a considerably higher share than millennials (22 percent) and Gen Xers (10 percent). Indonesians stand out: the average Gen Zer there spends 8.5 hours a day on the phone. In most countries, Gen Zers spend roughly two hours longer a day than Gen Xers and an hour more than millennials on their phones; they also spend more time on social media. That helps explain why 50 to 60 percent of the primary influence in brand decisions for Generation Z comes from social media and online sites.

However, Gen Zers are aware of the downsides of constant connection. In four of the six countries surveyed, they were more likely than millennials or Gen Xers to say people spend too much time on their phones and to believe that technology gets in the way of social relationships (Exhibit 2). In this regard, it's interesting that Gen Zers trust family and friends more than any other source—and more than millennials or Gen Xers do. More than half of Gen Zers surveyed—including 75 percent of Japanese respondents—say they think people overshare, and 49 percent are concerned about the use of their personal data.

Given those worries and Generation Z's high digital literacy, it isn't surprising that many Gen Zers actively manage their online identities. Of the Gen Zers surveyed, 36 percent said they "carefully curate" their online presence, compared with 31 percent of millennials and 24 percent of Gen Xers.

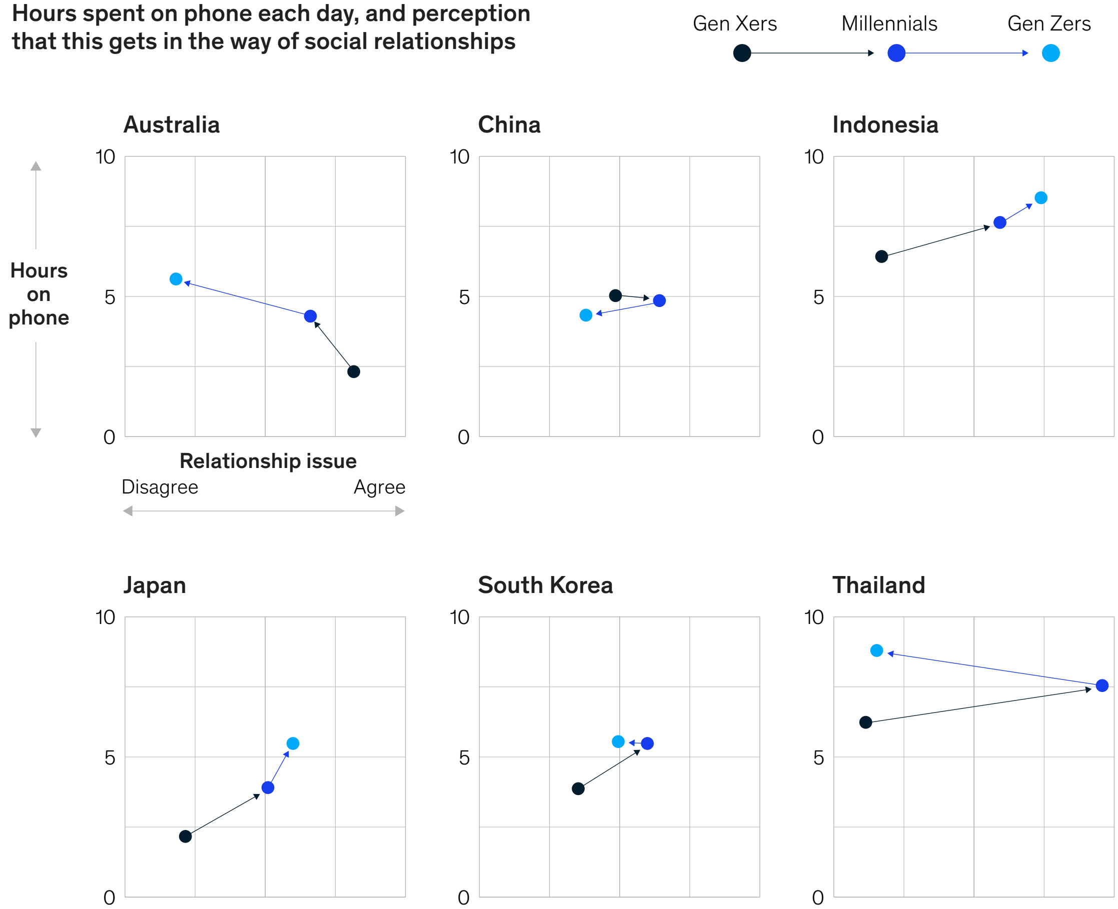
They want it all—and are used to getting it

Gen Zers like to research before they shop. They are especially interested in finding deals. Gen Zers are considerably more likely than millennials or Gen Xers to say that they always, or almost always, look for discounts. In Australia, 66 percent of Gen Zers surveyed say they always look for discounts before they buy, and in China, the share is 50 percent; that is ten percentage points higher than millennial peers. Gen Zers also want the benefits of personalization. Except in Japan and South Korea, though, they are generally less willing than

Exhibit 2

Gen Zers tend to spend more time on their phones than other generations do—and many worry it may be too much.

Hours spent on phone each day, and perception that this gets in the way of social relationships



Source: McKinsey Asia–Pacific Generation Z Survey, November 2019, n = 16,000

millennials to provide personal information to retailers and service providers.

Because Gen Zers are young and less likely to be working full time, they generally have less money to spend than older cohorts do; that may be behind some of their deal-hunting behavior. But they aren't willing to sacrifice quality for price. The percentage saying they would "prefer to buy higher-quality products which will last a lifetime" differs little between Generation Z and the other cohorts in most countries; 73 percent of both Gen Zers and millennials in China agree with this statement.

Gen Zers also expect a wide range of services and features, such as personalization, customization, exclusive or limited products, and brand collaborations. In Australia, for example, 61 percent of Gen Zers surveyed consider brands that collaborate with other trendy brands more interesting; only 51 percent of millennials do. In short, Gen Zers want more for less—making them, quite literally, tough customers.

They prefer brands that show their personality and uniqueness but that are also well known enough to be recognized
In brands, too, Gen Zers want it all. They are significantly more likely than Gen Xers to say they prefer brands that are popular with others—40 percent of Gen Zers surveyed look for popular brands, versus 34 percent of Gen Xers. In Japan, 51 percent of Gen Zers (compared with 31 percent of Gen Xers) say they prefer brands that are popular with others.

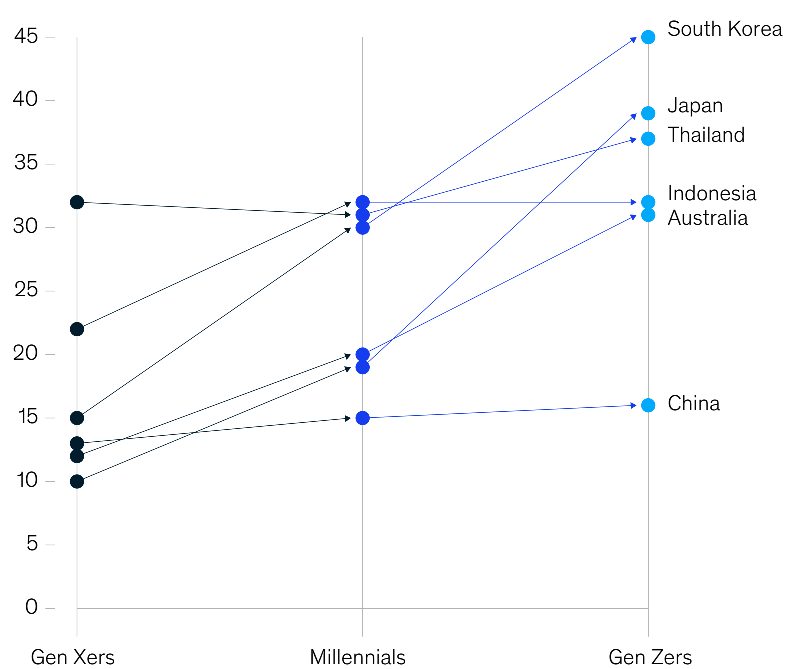
But Gen Zers are also more likely to say they want "brands that set them apart"—about twice as often as Gen Xers and 1.3 to 1.5 times more than millennials across APAC do. To reach Generation Z, then, won't be easy. Brands will need to balance achieving popularity through scale so that they are widely recognized while also maintaining a sense of relevance and distinctness that connects with younger consumers.

They are greatly influenced in their brand selection by video content
Gen Zers view significantly more video media on platforms such as YouTube or TikTok than other cohorts do. This influences how they choose brands and products. Majorities of Gen Zers in all six countries surveyed, and 70 percent overall, say they learned about new brands via video-based social media at least once a month. The overall shares of millennials (58 percent) and Gen Xers (46 percent) who say that are much lower. Video influences Generation Z not only in brand awareness but also in purchase decisions: in all six countries, Gen Zers are more likely than other cohorts to cite video as a top three influence (Exhibit 3).

Exhibit 3

Particularly in Japan and South Korea, many Gen Zers use video for brand- and product-purchase decisions.

Video sources are among top 3 influences for brand and product selection, % of respondents agreeing



Source: McKinsey Asia–Pacific Generation Z Survey, November 2019, n = 16,000

They want to be seen as environmentally conscious, but they often don't want to pay for this
Across APAC, Gen Zers say they care about sustainable consumption. Just as much as millennials, Gen Zers say they prefer environmentally friendly products, organic foods, and ethical fashion. For example, in China, 60 percent of Gen Zers and millennials surveyed state that they are trying to minimize the negative effects their eating habits have on the environment; half of both cohorts say they always look for locally sourced produce. In Japan, those attitudes are particularly pronounced; 54 percent of Gen Zers say they always look for clothes produced sustainably, and 46 percent prefer to wear used clothing—much higher figures than for millennials and Gen Xers.

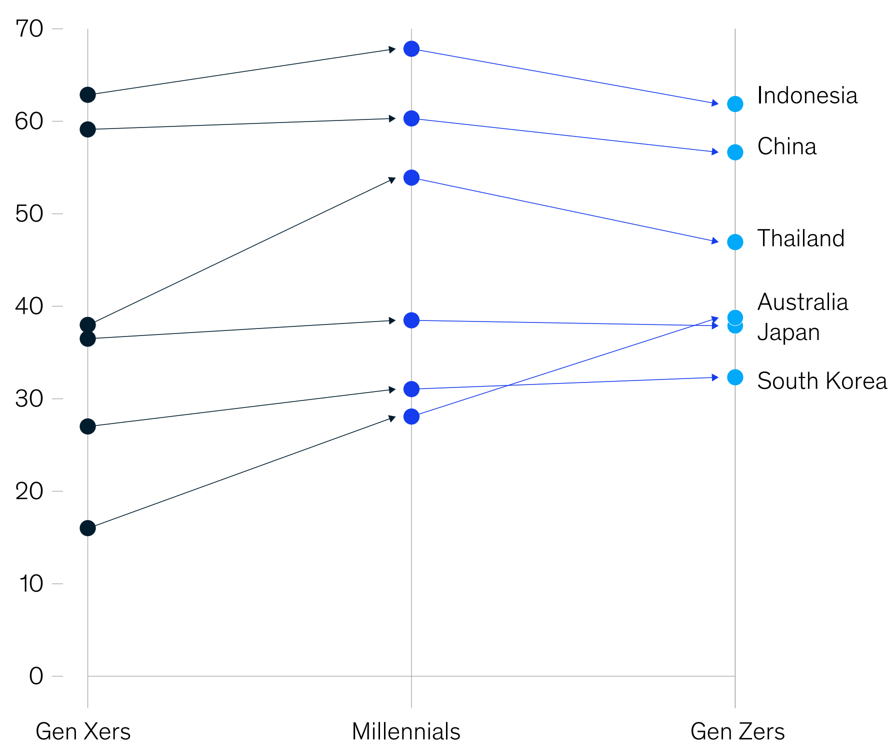
Extending beyond environmental consciousness, 60 to 80 percent of Gen Zers surveyed think that brands should be held to account for their actions. But only in Australia are Gen Zers noticeably more likely than their elders to say that they are willing to pay more for environmentally responsible products—39 percent for Gen Zers versus 28 percent for millennials and 16 percent for Gen Xers (Exhibit 4).

When digging into the underlying motivations for such attitudes, we found a strong correlation between the aspiration for sustainable consumption and the desire to be "on trend." In addition, those willing to pay more for green products also tended to be more conscious of brands in general. This suggests that buying and using environmentally friendly products and having a green mindset are associated with social status in the minds of Gen Zers.

Exhibit 4

Only in Australia are Gen Zers significantly more willing than other generations to pay extra for environmentally responsible brands.

Willing to pay extra for environmentally responsible brands, % of respondents agreeing



Source: McKinsey Asia–Pacific Generation Z Survey, November 2019, n = 16,000

Six kinds of Generation Z consumers

To assume that all Gen Zers are one homogenous cohort would be false. Through an analysis of the survey results, we identified six segments that, together, describe the Generation Z consumers in APAC (Exhibit 5). Brands need to understand these segments to develop products and services to meet Generation Z's needs.

Brand-conscious followers

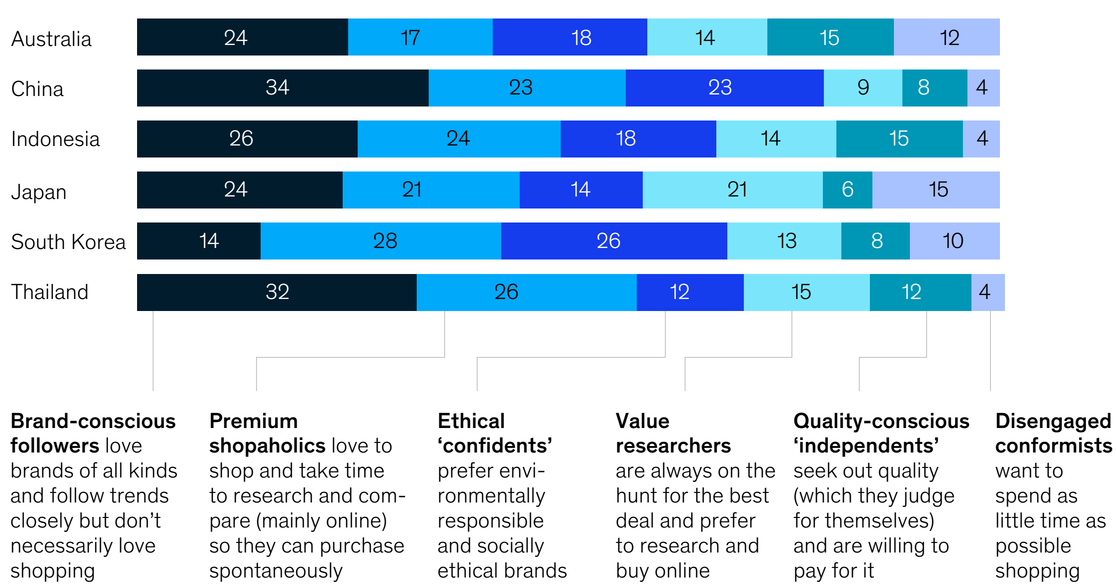
Brand-conscious followers make up the largest single segment (24 percent) of Gen Zers surveyed, composing roughly a third of those cohorts in China and Thailand and a quarter of them in Australia, Indonesia, and Japan (South Korea is the outlier, at only 14 percent). Brand-conscious followers love brands of all kinds, and they follow trends closely, but they don't necessarily love shopping. In Japan, half of that segment say they hate shopping for clothes, but 57 percent also say it's important for them to be on trend. Gen Zers in APAC tend to prefer buying online because it's more efficient. They know what they want, and they don't invest extra effort in finding the best deals, with 62 percent of Chinese Gen Zers in this segment finding online to be the best way to shop, and 45 percent loving to shop on Taobao or Xianyu.

For businesses, brand-conscious followers are critical resources. Not only are there a lot of them, but they tend to be early adopters of new products, services, and experiences. In Australia, a third of brand-conscious followers surveyed enjoy trying out products recommended by influencers, and 36 percent always follow brands they love on social media. But they are a tough audience to keep. While they like brands, they aren't particularly loyal to them: in Australia and China, brand-conscious followers are the least brand loyal of all six consumer segments.

Exhibit 5

Brand-conscious followers and premium shopaholics are the largest segments within Generation Z.

Generation Z population by archetype, %



Note: Figures may not sum to 100%, because of rounding.
Source: McKinsey Asia–Pacific Generation Z Survey, November 2019, n = 16,000

Businesses should be aware that while ethical confidents support sustainability in principle, they won't necessarily pay more for it. In South Korea, only 32 percent within the segment say they will.

Premium shopaholics
Premium shopaholics (22 percent of Gen Zers surveyed) *love* to shop. They take time to research and compare, mainly online, so that they can also purchase spontaneously. In South Korea, for example, half of the segment extensively research prior to shopping; at the same time, 20 percent—more than any other segment—often make spontaneous purchases. In China, 53 percent of premium shopaholics spontaneously make decisions on what to buy based on recommendations they receive as part of the shopping journey. To get exactly what they want, they are willing to pay a premium: two-thirds of Japanese and 75 percent of Chinese premium shopaholics want to trade up when they can afford to.

Additionally, premium shopaholics are conscious of how their consumption plays a social role: they want to fit in, but they also look for brands that help them stand out among their peers. In China and Japan, 61 percent of the segment want to stand out, and 65 percent want brands that are popular with other people. In Australia, it's the segment least likely to prefer smaller brands over well-known brands.

Finally, premium shopaholics are active in social media. They are twice as likely as those in other segments to say getting "likes" on social media is important to them. In China, for example, 49 percent of the segment say earning social-media likes is important to them—compared with an average of 26 percent in other segments.

The cohort is an obvious target for high-end brands because premium shopaholics are most likely to be willing to pay extra to get what they want. To get their attention, brands need to provide a convincing story of why a product or service deserves to cost more. Small brands with limited awareness may struggle with the segment because they don't offer the recognition that it desires.

Ethical 'confidents'
As the segment name suggests, these Gen Zers (20 percent of Gen Zers surveyed) prefer brands that are environmentally responsible and socially ethical. In Indonesia, 62 percent of the segment prefer natural and organic products, and 76 percent prefer to buy environmentally friendly brands—20 percentage points higher than in other segments. In all APAC countries surveyed, the segment constitutes a higher percentage of Gen Zers than of Gen Xers or millennials.

The relationship of ethical confidents with brands is fluid: they are open to trying newer and smaller brands, and they value customization and personalization. Compared with brand-conscious followers and premium shopaholics, they spend less time online and shop more in physical stores. They are confident in their choices and don't rely on others.

Given the buzz around sustainable consumption from consumers (as well as from regulators and industries), this segment is likely to grow. But businesses should be aware that while ethical confidents support sustainability in principle, they won't necessarily pay more for it. In South Korea, only 32 percent within the segment say they will.

Value researchers

Although not one of the larger segments (15 percent of Gen Zers surveyed), value researchers are worth getting to know because they have a high degree of brand loyalty. For example, 80 percent of Japanese value researchers always choose a brand they know over a new product. This isn't blind loyalty, however, as only half stick with a brand. Always on the hunt for the best deal, they prefer to research and buy online, with 90 percent of Japanese Gen Zers and 81 percent of Indonesian Gen Zers always researching before they buy.

Value researchers won't pay more just to get a higher-status brand. Because they are cautious, they often stick with what they know. Capturing the segment is about getting promotions and customer-relationship-management efforts right. For retailers, the segment is a moving target that is difficult to build a bond of loyalty with: value researchers will shop in multiple stores to get the best deal for the product they want.

Disengaged conformists

Disengaged conformists (8 percent of Gen Zers surveyed) are passive: they just don't care much about consuming. They want to spend as little time as possible shopping, and while they are happy to use discounts, they won't make an effort to find them. Once they find something they like, however, they tend to stick with it.

In Indonesia, 41 percent of disengaged conformists believe that all brands are pretty much the same, 53 percent always choose a brand they know, and 47 percent mainly shop spontaneously—the highest of all segments to do so. That may give major brands an advantage, as brand familiarity will go far with the segment. As disengaged conformists don't go looking for deals or new products, they need to be approached with offers and product features that speak to their needs in a targeted way. The cohort is largest in Japan (15 percent) and smaller in China, Indonesia, and Thailand.

Quality-conscious 'independents'

These Gen Zers (11 percent of Gen Zers surveyed) seek out quality, which is something that they judge for themselves—and are willing to pay for. They don't see a brand name as a guarantee of high standards. They prefer environmentally responsible and natural or organic brands—but more because they view those characteristics as identifiers of high quality than because of trendiness or a sense of ethics. In South Korea, only 26 percent of the segment always chooses a brand over a new product—the second-lowest figure among the six segments.

Winning over Generation Z

We have identified five principles that companies should keep in mind as they approach Gen Zers.

Relevance and speed are more important than ever

A significant share of Gen Zers surveyed see a major brand as a source of strength; they may associate the brand with quality (for premium shopaholics) or simply see it as an easy choice (for disengaged conformists). Across the region, Gen Zers are 20 percent more likely to try out new brands and products than millennials are, and they won't be loyal to brands that don't deliver.

Gen Zers want brands to be personalized, be customized, and help them be distinctive. Therefore, brands can't rest on history. To stay relevant in the market, brands need to leverage their legacy while investing in fast and continuous innovation—perhaps through partnerships and collaborations—running at the same speed as smaller and newer brands.

The quality and price equation has to be just right

Generation Z's high digital literacy and easy access to information enable its members to pick and choose to ensure that they are spending their money on what they really want. In a world in which most consumers research significantly before they buy, being competitive in both quality and price is a prerequisite to win the allegiance of Gen Zers.

Consumer companies need to understand which features consumers are willing to pay for. The markers of quality will be different in each segment because the segment members' values vary. For example, premium shopaholics are willing to pay more to get more; disengaged consumers aren't. To match quality expectations while keeping prices competitive, companies will have to be more stringent than ever in deciding which features to keep and which to deemphasize.

Social-media marketing needs to pay more attention to video

The role of video can't be underestimated: Gen Zers view significantly more video media on platforms such as YouTube or TikTok than other cohorts do. That influences how they choose brands and products. Brands that speak to Generation Z through informative, fun, and inspiring videos therefore stand a better chance of being shared—and thus cutting through the noise. Many brands have grasped that idea already, but there are far more misses than hits. Brands need to build their social-media marketing capabilities, whether real time or curated, to engage with consumers in a different way.

The brands that are winning are more creative, more authentic, and faster to market with their content. Producing the right video requires different skills than posting the right photo or the right tweet. Marketing teams need to have immediate access to production teams that can create a narrative and can shoot movies that move people and compel them to watch all the way through rather than clicking the skip button.

Being green isn't enough: Price and quality also matter

To capture a bigger share of the Generation Z wallet, sustainable products need to speak to quality as well as environmental values—and to communicate these attributes through a visually compelling story. Many small and successful ethical brands stand out by emphasizing their quality and story through package design and by posting videos and articles about how they came to develop their products. Bigger brands that want to expand their sustainable portfolios should do the same while ensuring that they can back up those assertions. Greenwashing won't do.

Brands need to be locally relevant

Although there are significant similarities among the markets surveyed, the game for brands should be local. Consumers in the region are naturally influenced by their distinct cultural attributes, lifestyles, religions, and eating habits. In Japan, Gen Zers are more likely to want to fit in rather than be unique; in China, they rely on brands, in large part, to define who they are; in Australia, they lean more strongly toward environmental responsibility and sustainability than older cohorts do. Brands need to ensure that their value proposition and messaging are tailored to the local context—and to the local distribution of consumer segments.

To reach APAC's Gen Zers, brands need to master distinct and sometimes overlapping qualities. They will also need to react to how the impact of the COVID-19 crisis is changing the attitudes and behaviors of Generation Z. Brands need to be both agile and stable, regionally aware and locally focused, environmentally sound and acutely price conscious, social-media savvy and respectful of privacy, and authentic and able to tell a compelling story. So yes, it's complicated, but as Generation Z's affluence and influence rises, it's well worth the effort.

Aimee Kim is a senior partner in McKinsey's Seoul office; **Paul McInerney** is a senior partner in the Tokyo office, where **Naomi Yamakawa** is a partner; and **Thomas Rüdiger Smith** is an associate partner in the Sydney office.

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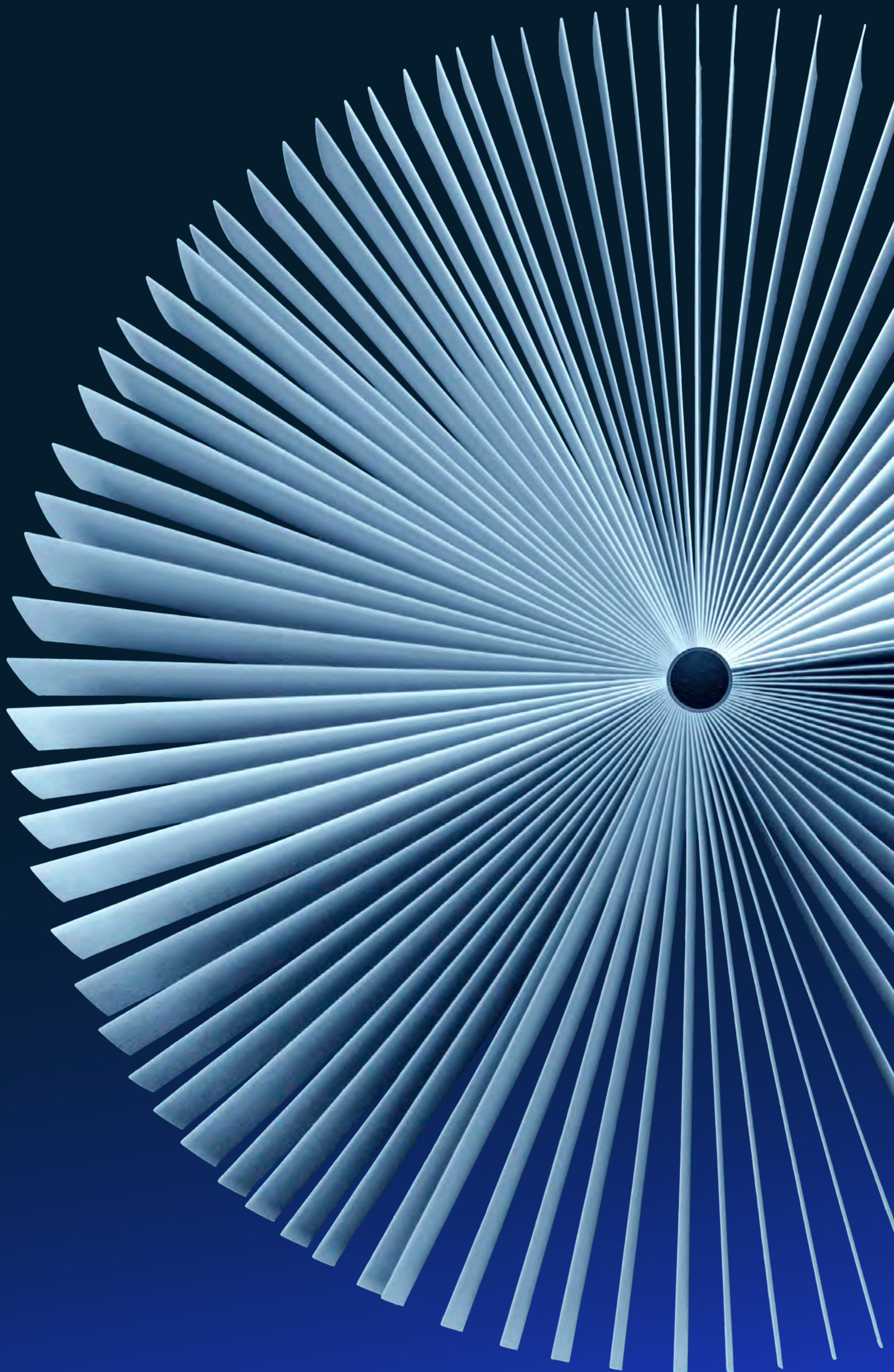
CEO perspectives



Connectivity with the consumer: A conversation with Nick Vlahos about The Honest Company's formula for growth

In his third year as the CEO of Honest, consumer-goods veteran Nick Vlahos has big plans for the fast-growing maker of baby and beauty products.

Photograph courtesy of The Honest Company

Over the course of a 22-year career at Clorox, Nick Vlahos managed a variety of product categories, including laundry, food, water filtration, bags and wraps, and personal care. Notably, he led the transformation of natural-products brand Burt's Bees into a global success. That experience prepared him to take on a new kind of challenge in 2017, when he left Clorox to become CEO of a much smaller but rapidly growing disruptor in the baby-products industry: The Honest Company, launched in 2012 by actress and entrepreneur Jessica Alba. Its promise of safe and effective products resonated with new moms nationwide.

In an interview with McKinsey's Greg Kelly, Vlahos shared his thoughts on the changing consumer and the future of Honest. The following are edited excerpts. (The interview took place before the COVID-19 crisis. For a July 2020 update, see the sidebar, "Staying Honest amid a global pandemic.")

McKinsey: *You rose up the ranks at a leading consumer-goods company with a long history. Now, you're leading a company that's been around for less than eight years. Some would say that's a risky move. Why did you do it?*

Nick Vlahos: It made a lot of sense for me to make this move, for several reasons. An important one is that The Honest Company was a great fit for me from a lifestyle and family perspective. The brand's ethos, its values, and what it stands for align very closely with how my wife and I and our four children operate as a family.

But it was also about anticipating where the consumer is going, both domestically and internationally. Think about how the packaged-food business has changed. Fifteen years ago, everything was set up for scale: new products were introduced with big marketing campaigns, pushed into stores, and stacked high. But then consumers started to become more educated and aware about what they were putting in their bodies. The health-and-wellness, "better for you" trend started to take hold. And over that 15-year horizon, organic food has become commonplace.

When I first started in the business, you'd walk into a store, and you might find a little section in the corner that was organic or natural. Today, when you walk into a store—say, Costco—every other pallet in the food section is organic.

And now, consumers are becoming more educated about not just what they're putting in their body but also what they're putting on their body—what they put on their skin, what they put on their children. I've found that the overall growth rates of natural, better-for-you, "clean" products are double the growth rates of conventional products. Consumers are spending their money on brands they believe they can trust.

McKinsey: *The Honest Company started as a direct-to-consumer [DTC] brand online, but in recent years—and especially since you came on board—the company has been building its omnichannel presence. Tell us about that evolution.*

Nick Vlahos: Let me just say a little bit about Jessica, because I think it's an important part of our story. She isn't a celebrity who just stuck a name on a product and introduced it into the market. She was a consumer first, and she got the idea for starting the company when she was pregnant with her first child. Why is that important? Well, the data shows that about 48 percent of new moms will change their purchase habits and their regimens when they're pregnant, and 50 percent will move toward better-for-you, clean products. That's a big insight for us. Being a digital-first brand, we educate and connect with you on a one-on-one basis during that aperture of pregnancy.

Let's talk about one of our subscribers. Let's say her name is Mary. We know that Mary has a child who's six months old and they live in Edina, Minnesota. I know that Mary is currently buying Honest diapers and wipes, but she's not buying Honest personal-care or beauty products. So when I connect with her, I want to offer her a solution set based on her needs. Her baby is going to grow, and Mary will eventually need, say, a different car seat. So I'm going to reward her

Nick Vlahos

Vital statistics
Born and raised in Chicago, youngest of 3 (has 2 sisters)

Married, with 4 children

Fluent in Greek

Education
Holds a bachelor's degree in telecommunications from Indiana University Bloomington

Career highlights
The Honest Company
(2017–present)
CEO

The Clorox Company
(2014–17)
COO

(2013–14)
Chief customer officer

(2011–13)
Vice president and global general manager, Burt's Bees

(1995–2011)
Various senior roles in sales and marketing

Helene Curtis Industries
(1990–95)
Sales executive

Fast facts
Is a board member of Tillamook County Creamery Association and has served on boards of Chabot Space & Science Center Foundation and Natural Products Association

Was included in "Glossy 50: Beauty's new guard" in 2018, a list of industry insiders driving important shifts in the beauty industry, by the publication *Glossy*

Was a guest lecturer on consumer-product strategy and operations at Fuqua School of Business at Duke University, Harvard Business School, and Kellogg School of Management at Northwestern University

"About 48 percent of new moms will change their purchase habits and their regimens when they're pregnant, and 50 percent will move toward better-for-you, clean products."

with a $5 Target gift card for a car seat. The goal isn't just to get her to buy Honest diapers and wipes—it's really to create loyalty, bring added value, and have her be excited about being part of the Honest family. Ultimately, it's about providing Mary the hyperconvenient experience that best suits her needs.

By rewarding her with a Target gift card, I've now created an omnichannel experience for Mary so that she'll go to a Target store and purchase a product. And by the way, since I have year-round distribution at Target and an endcap dedicated to Honest diapers, wipes, and personal-care products, she might also buy an Honest product while she's at Target. So my point is, by giving the consumer an experience that connects with how she shops and by creating solution sets that meet her needs, we start to create "stickiness" and loyalty to our brand.

As a consumer-packaged-goods manufacturer, you can choose to look at Target or Amazon as a competitor because they sell products that compete with your products. But I look at it this way: if I can create the right level of demand and interest in my product, then where I'm putting the product—whether it's Amazon or Target or Walmart—becomes part of a consumer-oriented solution set. Consumers—especially Gen Zers and the younger groups—have become channel agnostic. What they're interested in is accessibility, ease, convenience: being able to procure a product where and when they want to procure it. They don't think in terms of channels.

Staying Honest amid a global pandemic

In July 2020, more than three months after Honest employees began working from home, Nick Vlahos offered these additional perspectives.

McKinsey: *What shifts in consumer behavior have you seen as a result of the COVID-19 crisis? How is Honest responding to these shifts?*

Nick Vlahos: We're constantly listening and responding to the wants and needs of our customers. Even through the pandemic, our internal labs have continued to innovate and to narrow their focus on product developments that respond to new consumer lifestyles. In fact, this year, we will be introducing 50 new products, several of which are in response to COVID-19 and are focused on sanitization. Looking to the future, we will double down on innovation, focusing on the importance of omnichannel and accessibility—two keys to our success both prior to and during the COVID-19 pandemic.

McKinsey: *How has COVID-19 changed the way you work?*

Nick Vlahos: During this time, the safety, health, and well-being of our Honest family—employees as well as customers—have been of the utmost importance to us. Due to our omnichannel strategy, throughout the COVID-19 crisis we've been able to get our products to consumers. We've been able to ensure that supply of our essential products—like diapers and baby wipes—remained strong.

On March 13, all our employees began working remotely. Connectivity and constant communication have been key to our success in this new operating model. We've made it a point to be as transparent as possible with our Honest family by sending regular updates on the status of our workspace via email, our HR hotline, Slack, and our intranet, Inside Honest. We've also been working with our partner, Thrive Global, which specializes in workplace wellness. Together, we developed a customized training session on Honest University to help our employees navigate ambiguity, deal with stress, and handle the impact of COVID-19 during this difficult time.

As we can't meet in person, we're using Honest University to host "Launch and Learns" for our employees so they can learn all about the new products we are launching, including the marketing and retail plans for those products. Our goal for these training sessions is to help our employees become true ambassadors of Honest products.

Photograph courtesy of The Honest Company

McKinsey: *It's true that it's no longer helpful for consumer-packaged-goods [CPG] companies to think of channels in terms of discrete shopper occasions. Still, many CPG companies are wrestling with pricing across customers. Did you make any changes to the pricing philosophy and architecture of Honest products when you started selling through mass retailers?*

Nick Vlahos: No. To succeed as an omnichannel brand, you have to start with the right value proposition for your product. What price can you command every day for that product, how do you drive accessibility based on where consumers want to shop, and how can you make money doing that day in and day out?

The issue for some CPG brands historically has been that the value proposition is off—and if it's off, you have to rely on trade spending, and you have to play a high–low operating game in the marketplace. You then become disadvantaged quickly, based on how the Amazon algorithm reads your pricing or how Walmart is establishing pricing. You get tangled into a channel discussion. And you start creating different value propositions in different places that the consumer may not be interested in at all.

McKinsey: *Honest has successfully expanded into not only new channels but also new geographies: you're now in Europe. How do you decide which markets to enter?*

Nick Vlahos: It's important to have the right product profile to be able to quickly get into a market. We did consumer research to understand where the Honest brand can resonate—where consumers are interested in better-for-you, wellness-oriented products. Some folks might say, "Well, Europe is further along than the United States when it comes to that trend." But if you look, for example, at how many ingredients are banned in the European Union, the number is about 1,300, whereas Honest has about 3,000 ingredients that we try to avoid—ingredients that are thought to be harmful to people's health or to the environment. The fact that we have high standards for our product formulations and our testing means we're able to play in these markets; we don't have to reformulate our product lineup.

Having the right strategic partner in every geography is also important. In continental Europe, we've partnered with Douglas, the largest retailer in the beauty space, and with Boots in the United Kingdom. We've done a lot of work with our partners to localize our marketing plans. The product is common in those geographies, but the marketing elements—the social media, the influencers that we're working with—are all localized. Thanks to our targeted, multilayered approach, we're strengthening existing consumer relationships while forging new ones in new geographies.

McKinsey: *What gets you most excited as you think about where the brand can go?*

Nick Vlahos: One thing that excites me is that we're at the forefront of another consumer trend: minimalism. More consumers are becoming minimalists when it comes to their beauty regimens: they're not interested in doing a ten-step process to "put their face on" every day. They're busy; they're on the go. Honest Beauty products align with that trend.

From a digital-marketing perspective, what gets me pretty jazzed is creating the right level of content and community and translating that into commerce. For example, we're giving consumers "snackable" content—information in bite-size morsels and pieces—about what they should expect during the 40 weeks of pregnancy. We found five different women, with different backgrounds, different geographies, different life experiences. And we documented, over a 40-week time period, each of their lives and what they were experiencing.

So if you're pregnant and you like Kasey and her story, you can go to Honest.com to see content about her journey. How does she balance work with pregnancy? What's it like to plan a gender-reveal party? What should I do during the nesting period? That content has been really powerful for us. It's enabled us to create more of a community. We can then connect with each of our customers and offer each of them a solution set based on her unique experience.

McKinsey: *You've talked about what people put on their bodies as well as in and around their bodies. What will you offer your customers next? How far do you think the brand can extend? Could you imagine Honest food or Honest air purifiers?*

Nick Vlahos: Over the past couple of years, we've really focused on the on-your-body component. We have a connection with the consumer, and we have insights into what you're putting on your baby's skin, so we started thinking about what you put on your own skin and what you put on your family's skin. Going from baby products to beauty products made sense. We've invested disproportionately in the safety and performance of our products to develop everlasting trust. We spend a lot of time on our products so that we can consistently delight consumers. And we're innovating fast. In my former job, I would say the innovation process was always over a two-year horizon or so. At Honest, our innovation process is six to 12 months.

As disruptors in the natural baby and beauty categories, we are constantly listening and responding to consumers' wants and needs, which will always be core to our evolution. For adjacencies to work, there has to be connectivity with consumers and their behavior. Can I start talking about beauty from within and what you're putting in your body? Yes. Could I get into the food business or the supplement business tomorrow? Absolutely. But do I have the capability set to deliver the margin accretion I'm looking to deliver across my portfolio? No. That day will come, but for now I'll stay within my lane and build the brand with the consumer at the core while focusing on the performance of the product.

Greg Kelly is a senior partner in McKinsey's Atlanta office.

Leading with purpose and humanity: A conversation with Hubert Joly

Best Buy's former chairman and CEO reflects on a business's reason for being by defining it around purpose and humanity, the link to competitive advantage, and managing shareholders and stakeholders during a crisis and beyond.

by Bruce Simpson

This article first appeared on McKinsey.com in May 2020.

In a recent poll of customers' reaction to the COVID-19 crisis, more than 80 percent of respondents said they would remember which companies "did the right thing by their workers" in dealing with safety measures or efforts to avoid layoffs. Three-quarters said they wouldn't forget those businesses that took missteps "long after" the crisis ends.[1]

This is familiar terrain for Hubert Joly. After joining Best Buy as CEO in 2012, Joly engineered a dramatic transformation of the ailing electronics retailer and built a reputation over time as one of the business world's most visible advocates of defining a business's reason for being with social purpose and people as a guiding star. Today, as more and more executives grapple with the need to incorporate the needs of all stakeholders into their leadership choices, Joly's experience reflects the challenges and opportunities inherent in mobilizing customers, vendors, and other stakeholders in pursuit of what he calls "noble purpose." In this edited interview, Joly, a McKinsey alumnus, shares his thinking with McKinsey's Bruce Simpson about personal purpose and managing the evolving landscape of corporate purpose during COVID-19 and beyond.

Personal purpose

My individual, personal purpose is to try to make a positive difference for people around me and then to use the platform I have to make a positive difference in the world. This is an evergreen purpose, meaning, whether I'm the CEO of Best Buy or starting my next chapter, it's always true.

It stems from a reflection on what work is, because, of course, work is a big part of our lives. You can see work as a curse, as a punishment because we sinned in paradise. I tend to see work as being essential to our humanity and to our fulfillment, part of our quest for meaning. It's not something you do so that you can do something else; it's something that's essential to our lives. I think it's essential when we lead companies that we recognize this for all of the people working at the company—and that we can connect their individual purpose with the purpose of the company.

Pursuing 'noble purpose'

These days most companies, and most leaders, believe in the importance of purpose, and there is a broad-based realization that excessive focus on profits is wrong. The question is often, "So where do you start and how do you sequence?" The logical part of our mind would have us start with purpose, then derive the strategy: anchor it in purpose, and transform the organization on that basis.

My personal experience is different. When we started the turnaround, I was very clear about my philosophy, which was that profit is not the purpose. Purpose is to contribute to the common good. But we did not spend time in the first three years of the turnaround on refining our purpose. We spent the time saving a ship that was sinking, by addressing key operational-performance drivers.

We also spent a lot of time—and I can see it very clearly with hindsight—on making sure that the soil of the company was fertile. Do you know the parable of the sower? If the seeds fall on stones, nothing is going to happen. You may have perfect seeds, but they aren't going to grow. So a lot of our emphasis was on creating a joyous, growth-oriented culture, and on creating a very human environment where people felt that they belonged, that it was a human organization, that we emphasized individual development.

How do you define that noble purpose? I believe you find it at the intersection of four circles: what the world needs, what you are good at, how you believe you can make a positive difference in the world, and how you can make money.

[1] *Survey: What Americans want from corporate America during the response, reopening, and reset phases of the coronavirus crisis*, Harris Poll in partnership with JUST Capital, May 7–11, 2020, justcapital.com.

“A lot of our emphasis was on creating a joyous, growth-oriented culture, and on creating a very human environment where people felt that they belonged.”

So the sequence of steps is not always going to be, “Start with purpose.” A lot of companies are focused on that, but it may not be the best point of attack. When you start working on defining purpose, the danger is to make it too abstract, too glossy.

No. It needs to be grounded in true customer needs, and true demonstrated abilities to achieve competitive advantage. Your dream, of course—but also the ability to make money: something that’s very real, tangible, and tightly connected to the growth and profit engine of the company.

The danger of the fact that purpose is very much *en vogue*, paradoxically, is to put too much emphasis, too early, on it—as opposed to really finding the right time and the right approach to go after it.

If the definition of purpose is too much for the website, people say, “Well, that’s not my reality.” So how do we make it real and how do we unleash that human potential?

People first

At the end of the day, a company is a human organization made of individuals working together in pursuit of a goal. These individuals produce value for all stakeholders. They are the source, not simply a resource. In a turnaround, typically people tell you, “Cut, cut, cut.” My approach to turnarounds is essentially the opposite; it’s to start with people. I spent my first week on the job in a handful of stores, starting in the store in St. Cloud, Minnesota, to listen to the front liners and learn from them what was happening. That’s how we decided to invest in the shopping experience online and in the speed of delivery, to neutralize the advantage of online players. We also invested in the store experience, partnering with the world’s foremost tech companies to develop stores within our stores. On the cost side, we started by looking at how we could attack nonsalary expenses. Head count was a last resort—starting not with the front liners but with the top of the house. In eight short weeks in 2012, we constructed a plan that we called “Renew Blue.” We co-created it, we didn’t go for perfection, and then we got the bicycle going in a turnaround, creating momentum and energy. (For a detailed look at Best Buy’s transformation, listen to “Transformation and resilience: An interview with Best Buy’s executive chairman Hubert Joly,” on Apple Podcasts.)

Shareholders as customers

When we presented our Renew Blue plan to our investors, it had all of the stakeholders you have to engage as you lead these turnarounds: customers, employees, vendor partners, community, and shareholders.

With the shareholders, our approach was very simple. We shared with them, in November 2012, our diagnosis of our strengths and our opportunities. We were very transparent. We gave them the overall framework and our long-term targets. I don't think you impress shareholders just by the words you use. It's more around the say–do ratio. So in the following quarters, we really focused on doing what we had said we were going to do, on reporting quarterly progress, on showing them concrete opportunities, and on demonstrating how we had gone after them. That allowed us to build credibility; delivering quarter-after-quarter progress was very helpful.

Sometimes there is a debate: as a company, "Do we need to focus on the short term or the long term? And do shareholders force you to do crazy things because of a short-term focus?" I think that's a wrong, an artificial, debate. I'm a big believer that 98 percent of the questions that are asked as "either/or" are better answered as "and." Of course, you need to focus on the long term. *And* you need to focus on the short term. I've also always found that if you tell the investors, "Look, I'm going to be investing in this area, and the payback is going to look like this," they're very open to that. They want you to create long-term value, so if you're logical and you follow through with a track record of delivering results, they're very open to this. Any management team that relies on excuses related to shareholders, is, I think, misdirected. In the end it is about treating shareholders as customers.

Measuring purpose

These days most companies, and most leaders, believe in the importance of purpose. And there is a broad-based realization that an excessive focus on profits is wrong. It's of course the easiest thing to measure. There are generally accepted accounting principles [GAAP]. And at the end of each month, you know what your profit is.

The problem is that if you focus too much on this outcome you're actually going to be tempted to do the wrong thing. And, by the way, anybody who believes that your GAAP numbers, even your non-GAAP numbers, are a good measure of the economic value creation for a business, is wrong.

If you dig into it, accounting has never really been designed as a way to represent economic value. For example, you always write down goodwill, but you never write it up. I think the key in leading companies is to have a balanced scorecard, to have KPIs [key performance indicators] that are focused on customers, like a customer-satisfaction score or revenue per customer; on employee engagement and turnover; on vendors and how the relationship with them is going; your impact on and reputation in the community; *and* on financial performance.

So it's a matter of managing this holistically. And I think as proxy advisers or rating firms work on measuring performance, I am encouraged by the trend toward measuring an increasingly broad range of dimensions. More can be done, though, in particular in the area of evaluating executive compensation. Proxy advisers focus their evaluation on total shareholder returns over one year, three years, five years. That seems to indicate that profit is the only thing that matters. There is increasing realization that having a purpose—a long-term strategy, taking care of all of your stakeholders, doing well by doing good—is the right approach.

So we have a bit of a lag here. I think that over the next several years there will need to continue to be some work on that. There's been some interesting work by the SASB [Sustainability Accounting Standards Board] and a few others. We're not there yet, but I think we have to continue to move forward in that direction.

Customer purpose

When we did market research, we saw that although many of us love technology, and there are a lot of exciting new products and things that we can do with technology, it's complicated, and can be confusing. We need help as customers.

“One of the diseases that exists in the world is the notion of zero-sum games. You lose, I win. I win, you lose. That’s wrong.”

So the purpose of Best Buy, in relation to customers, is not just to sell you a TV or a computer—though we’ll gladly help you buy one. But it goes beyond that. It’s about what we call enriching lives through technology by addressing key human needs. The reason people buy a computer or a phone is not really for the product; it’s for what it can do.

Focusing on underlying human needs unleashed a lot of growth opportunities—such as our strategy to help aging seniors live in their homes independently, for longer, by putting sensors in their home, under the bed, in the bathroom, in the kitchen, or even on themselves for full detection. Through remote monitoring and artificial intelligence, we can help detect whether something is going wrong and trigger an intervention. That’s a real need, and note how the strategy is not focused on the fact that we have brick and mortar stores or that we are a retailer. It’s based on addressing human needs.

Interestingly enough, we have a second purpose, which is to help the world’s foremost tech companies to commercialize the fruit of their billions of dollars of R&D investment. It’s not about “showrooming,” it’s about showcasing—helping customers understand what can be done. And it’s been a critical element of our journey, our purpose, and our economic equation.

Vendors as partners

The way we dealt with our vendor partners, Amazon or Apple and so forth, illustrates our basic philosophy of leading with purpose and humanity, by taking care of and working with all of our stakeholders. You could see these vendors as competitors, right? Amazon, in some ways, is a competitor. Apple is an important vendor, but it also has its own stores. What we decided was to cooperate with them. One of the diseases that exists in the world is the notion of zero-sum games. You lose, I win. I win, you lose. That’s wrong.

With Amazon, we decided that they were a developer and manufacturer of great technology products that customers wanted. So of course we were going to sell these products in our stores. Amazon now has corners in our stores next to Google—which is great for customers. They can see the various opportunities available, and they can understand what can be done with that.

We’ve even gone beyond that. One day—it was April 2018—Amazon and Best Buy announced a partnership where Amazon gave us the exclusive rights to their Fire TV platform to embed that platform into smart TVs. These smart TVs powered by Fire TV are only available at Best Buy or by Best Buy on Amazon.com. So it creates opportunities. Similarly, Apple has its own stores, but the Apple store within Best Buy is a way to expand access to

Apple's products for more of its customers. So it's a case where the customers win, the vendor partner wins, and we win as well.

Purposeful leadership

One thing I want to add is what this focus on purpose and humanity means from a leadership standpoint.

The first thing is to be aware of what drives you as a leader. Be clear about your purpose as a leader, the purpose of the people around you, and how all of this connects with the purpose of the company. If you are driven by power, fame, glory, or money, this is a danger zone. Your role as a leader also is not to be the smartest person in the room and to make sure that everybody around you knows how smart you are. It's to create an environment in which others can be successful.

We need leaders who lead with all of their body parts: their brain, their heart, their soul, and their gut. Especially in a crisis like we have today with COVID-19, using your instincts and your intuition is also important. So use all of your body parts.

Perfection is very dangerous because you work on a team, and on your team you have other human beings. And guess what? They're not perfect. They're making mistakes. Being able to say, "My name is Hubert, and I need help," is a good exercise that creates a much better outcome.

On COVID-19

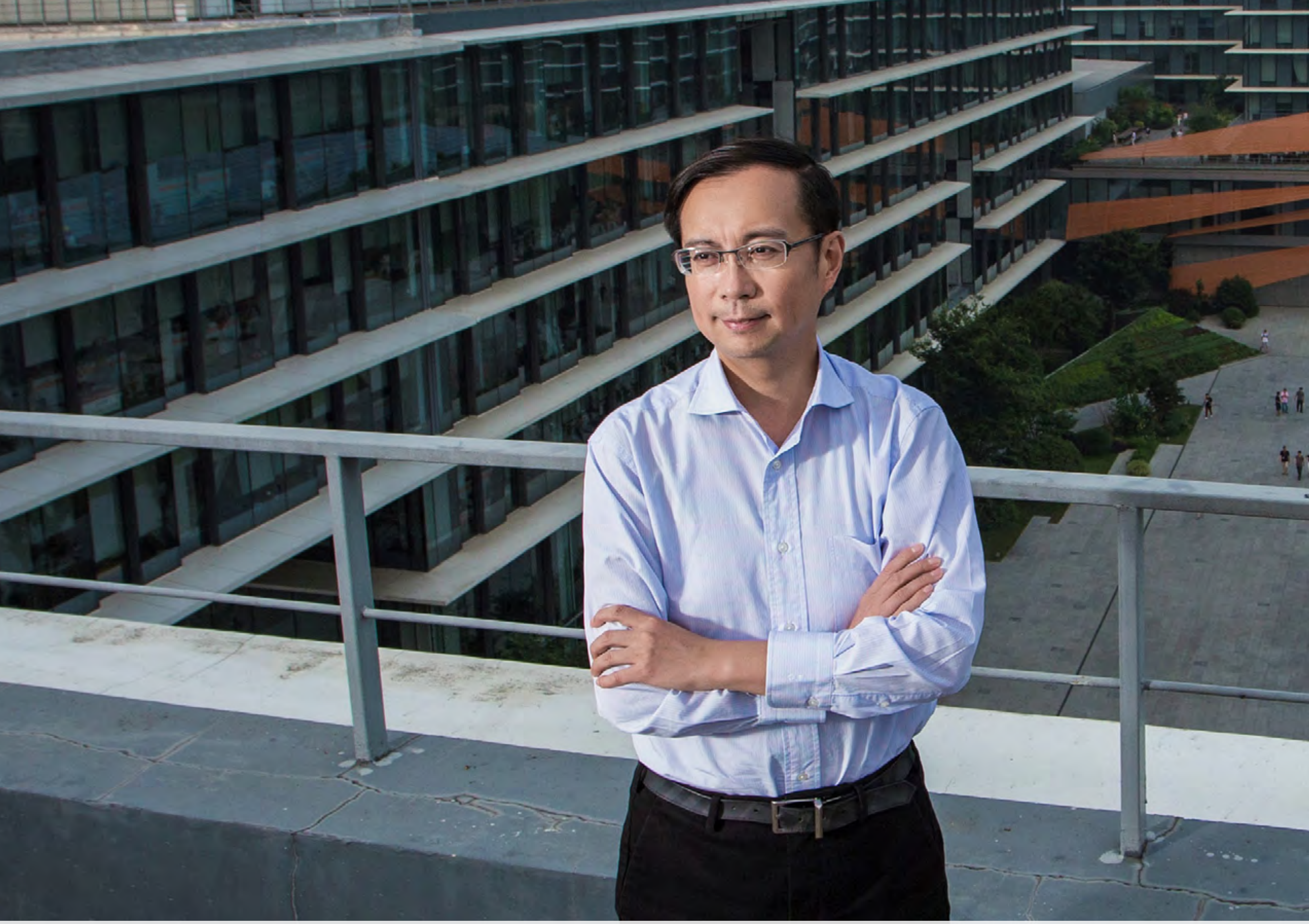
In this COVID-19 crisis in particular, I've seen a lot of leaders being OK with saying, "All right, this is what we know at this point, this is what we don't know, this is the work we're doing to figure out the answer"—but not feeling the need to have answers to all of the questions and giving the impression that no mistake is being made. In fact, I think any leader knows that creating an environment in which it's OK to make mistakes is something that makes complete sense. So beware the concept of perfection. Embrace vulnerability.

For me, one lesson from this crisis is around how we define performance. This is a time when our performance as leaders is not defined by our share price or earnings guidance. It will be measured by how we treat employees, how we deal with our customers and communities. Back in 1940, Winston Churchill spoke about Britain's finest hour. This crisis can be our finest hour as leaders, but it requires that we ask ourselves a few questions.

One is, are we taking the time, first, to take care of ourselves? That means sometimes hitting the pause button and being clear about how we want to lead. The second question is, what actions are we taking and what is driving them? I am inspired by many great examples of companies taking care of their employees, not laying them off but perhaps putting them on furlough. In Europe, they have put in measures that enable employees to stay on payroll, with government subsidies. Employees will help us move forward. I think this crisis will accelerate the movement toward the necessary refoundation of business and capitalism, around purpose and humanity, and I want to be part of it.

Bruce Simpson is a senior partner in McKinsey's Toronto office.

He wishes to thank Becca Coggins and Jinchen Zou for their contributions to this interview.



Speak softly, make tough decisions: An interview with Alibaba Group chairman and CEO Daniel Zhang

The chairman and CEO of China's e-commerce giant describes Alibaba's approach to innovation and how he balances analytics and instinct to push himself to spot hidden opportunities.

by Daniel Zipser

Photograph courtesy of Alibaba Group

This interview first appeared on McKinsey.com in September 2019, before the COVID-19 outbreak. Some facts and figures were updated in February 2020.

While visionary founder Jack Ma has provided Alibaba Group's most public presence during the company's journey from apartment start-up to global e-commerce powerhouse, current chairman and CEO Daniel Zhang can be credited with many of the company's game-changing successes. Nonetheless, the pair present as opposites—Zhang, with calm and collected cogitation, in the face of Ma's restless dynamism—a duality that drew attention when Ma nominated Zhang last year to succeed him as company chairman in September 2019.

Zhang, known on Alibaba's Hangzhou campus by a nickname that translates to "the free and unfettered one," had hitherto eschewed the spotlight, but his instinct for innovation proved instrumental in Alibaba's rise to become the world's most valuable e-commerce company in 2017. Among Zhang's initiatives is Alibaba's annual 24-hour sales promotion, known as the "11.11 Global Shopping Festival," or "Double 11" for short, which notched gross merchandise volume of $38.4 billion in just 24 hours in 2019. Zhang was also at the forefront of Alibaba's drive to become a mobile-first business: more than 90 percent of sales on Alibaba's China e-commerce sites are now made via mobile device. More recently, the Shanghai native spearheaded the launch of Freshippo (known as "Hema" in Chinese) grocery stores, which combine a high-end, in-store experience centered on fresh foods with rapid e-commerce home delivery and a robot-staffed restaurant option.[1]

In this interview, Zhang talks with McKinsey's Daniel Zipser about Alibaba's approach to innovation, the power of purpose at Alibaba, and how Zhang balances analytics and instinct to guide his own decision making and push himself to spot hidden opportunities. The following is an edited version of their conversation.

McKinsey: *What strikes you as notable about Chinese consumers, and how are they evolving?*

Daniel Zhang: What we see from our digital platforms is that they are very diverse. Because of the internet, they know what's popular—not only in China but all around the world. They also have strong beliefs. Generation Z, for example, doesn't believe only in so-called big brands; they prefer unique things and new brands from their own generation. That's [a big part of] their lifestyle. The other important thing is that they tend to spend more. China is famous for being a high-savings-rate society, but the younger generation are more willing to improve their lifestyle through spending, and that presents huge opportunities.

McKinsey: *Speaking of consumer spending, Double 11, the online shopping festival that happens on November 11 each year, generated more than $38 billion in gross merchandise volume in 2019. What was your vision when you launched the event back in 2009?*

Daniel Zhang: Tmall [Tmall.com] is now the largest online B2C business in the world, but at the time, it was tiny compared with Taobao [Taobao Marketplace]. So we wanted people to remember us. The idea was to bring together all the merchants on Tmall and create a common event where we could work together to serve our mutual customers with the best service, the best products. We never dreamed it would become such a fantastic event ten years later, and that really reflects the power of ecosystems.

But if you ask me about the idea on day one, I have to say it came from a sense of, "How can we make people remember us?" and "How can we survive?" From there, it came from trying new things. Going forward, it will continue to be about innovation. We will look to promote not only online sales but also brick-and-mortar stores. Double 11 is a day focused on consumers, and they seek online as well as offline experiences. That's a very obvious trend we see and will pursue as we continue to make Double 11 the best day of the year for consumers.

McKinsey: *Say more about innovation and technology at Alibaba—and, in particular, the role of artificial intelligence [AI].*

Daniel Zhang: We are always trying new things—always innovating services and using technology to give consumers new experiences. For example, people in China are now largely used to the convenience of mobile wallets, so we have pushed to promote facial recognition as confirmation for

[1] See Uptin Saiidi, "Inside Alibaba's new kind of superstore: Robots, apps and overhead conveyor belts," CNBC, August 30, 2018, cnbc.com.

Daniel Zhang

Education
Earned a BA in finance from Shanghai University of Finance and Economics

Career highlights
Alibaba Group
Chairman and CEO
(Sept 2019–present)

CEO and director
(May 2015–Sept 2019)

COO
(Sept 2013–May 2015)

President, Tmall.com
(June 2011–Sept 2013)

General manager, Taobao Mall (subsequently rebranded as Tmall.com)
(Aug 2008–June 2011)

CFO, Taobao Marketplace
(Aug 2007–June 2011)

Shanda Interactive Entertainment
CFO
(Aug 2005–Aug 2007)

Fast facts
Responsible for launching Alibaba's "Double 11" Singles Day event—now the world's most successful retail promotion

Photograph courtesy of Alibaba Group

digital payments. Feedback tells us young Chinese consumers love the convenience of this; it's a fantastic consumer experience.

We had been working on AI for many years, but, to be honest, we didn't even realize what we were doing was AI. We are a data-driven company. We create value from the data generated by real activity of users and merchants; we use data as fuel for our marketplaces to help merchants better serve their customers. That is our logic, and we have been working on this for many years.

Technology and data empower our whole business—not only on the sales side and marketplace side but also in the back-end office, in customer service, in every single area. This is how we work. So when people say "AI," we laugh and say that, to us, it's "Alibaba intelligence" because data and technology power everything we do.

McKinsey: *How would you describe Alibaba's purpose, and how does your business model support it?*

Daniel Zhang: Alibaba has been a mission- and vision-driven company from day one. Jack Ma, along with 17 other early cofounders, set a great mission: to make it easy to do business anywhere. Our mission drives our business strategy, which is empowering our business partners.

Even though our business is always evolving, the mission remains unchanged. For example, we are not only helping big brands and retailers—we also help small and medium businesses grow. We believe small is beautiful; we want to help new businesses and entrepreneurs be more successful. That's always been our philosophy. In this digital era, when we talk about Alibaba's future, we focus on helping our business partners win through successful digital transformation, rather than about how we can make ourselves even stronger. When small businesses can grow faster and grow healthier, it will benefit the whole society.

“We believe small is beautiful; we want to help new businesses and entrepreneurs become more successful,” says Daniel Zhang, shown here with McKinsey’s Daniel Zipser at Alibaba’s headquarters in Hangzhou, China.

Photograph courtesy of Alibaba Group

As the Chinese economy transforms into a consumption-driven economy, Alibaba has a huge opportunity to understand consumers’ changing needs. We help connect the whole world with China to facilitate easy trading and access to the world’s largest consumer market.

McKinsey: *You are often described as reserved, soft spoken, and detail oriented. How do you see yourself as a leader, and how has your leadership style evolved?*

Daniel Zhang: I don’t think I’m a reserved guy, actually. People may tag me based on my background as an auditor, and I always say that maybe I picked the wrong first job. Obviously, though, that first job gave me a lot of opportunities to learn the basic skills and have access to many clients in different industries. I consider myself very lucky to be engaged in the digital landscape and to be part of such a fantastic company in Alibaba.

In terms of my leadership style, I’m very nice to people. I tend to give people opportunities to try their own ideas, but I’m very tough once a decision has been made. Once I make up my mind, I want my teams to go ahead and get concrete results. That’s why people at Alibaba always say it’s very difficult to deal with me in business meetings, because [in that context] I am always trying to get to the substance of the matter and drive people to make progress.

So my leadership style is that, yes, while I speak softly, I always make the tough decisions. I think the most important thing [for a leader] is to lead the whole team forward. They need direction, and they need clear guidance. Leaders have to make the tough decisions, even if it may not be the perfect decision. At the same time, I also try to learn from our young people—the people born after 1990, 1995. Learning about their lifestyle and preferences helps give me a lot of new ideas and inspires innovation.

McKinsey: *How much of your process for making tough decisions is intuition compared with data analysis?*

Daniel Zhang: It’s a combination. Our advantage is having huge amounts of data, and my team does a fantastic job in providing me with daily analysis. But as a leader, you have to see something which others cannot, and often that comes down to focusing on customer pain points.

About four years ago, I had the idea for the Freshippo retail stores, which have since become very popular. My original thinking was that traditional e-commerce's hub-and-spoke model could not deliver fresh products on time and on demand. It's not like you can deliver fresh fish to a customer's home while she is still in the office. We had to rearchitect the business model and address that particular pain point, and that process led to the origin of Freshippo.

Pain points mean opportunity. And that's why, every year, I do a self-evaluation process during Chinese New Year. I ask myself, "How many new ideas, how many new businesses did I initiate last year?" I don't focus my self-evaluation on the performance of the existing businesses: this is about the new opportunities. Today they may be new ideas—very tiny, very small—but they may become much bigger in the future. Maybe they will become a main business for Alibaba.

McKinsey: *Among those ideas, there will inevitably be failures as well. How do you handle failure as a leader, and how does Alibaba approach the topic as an institution?*

Daniel Zhang: We give our people a lot of space to try new things. It means you have to accept mistakes. The vast majority of innovations will result in failure; you have to acknowledge that. But the key is, can we learn from the failures?

For example, five or six years ago, we tried a new thing. It was a digital social-messaging platform called Laiwang. We started the business, invested heavily, sent some of our best people, but it failed. We didn't create a new experience for consumers that differentiated from what they could already get in the market.

That experience served as a critical lesson that informed our thinking when we created DingTalk, a cloud-based, SaaS [software-as-a-service]-based work-collaboration platform. The tool is a direct result of Laiwang's failure because the team realized that people have too many contacts on their social networks. Users wanted

"The experience of new things is not only fun, but it also makes you feel younger," says Daniel Zhang.

Photograph courtesy of Alibaba Group

We give our people a lot of space to try new things. It means you have to accept mistakes. The vast majority of innovations will result in failure; you have to acknowledge that.

an alternative messaging platform dedicated to work relationships and communication. DingTalk's success is another example of a pain point inspiring a new service. It's an example of valuable lessons we can harvest from failure.

McKinsey: *What motivates you, personally, as a leader? What drives you when you get up in the morning?*

Daniel Zhang: First, it's about having fun. That's the most important thing. I work with many young people in our line of business—the digital landscape is a brand-new frontier for society—and the experience of new things is not only fun, but it also makes you feel younger. I always say to my friends, to my team, that the key thing to ask yourself is, "Do you still have curiosity about the world?" If you are curious about the world, then you will find something different, then you will find new opportunities, and you will move ahead.

McKinsey: *Finally, you've worked alongside Alibaba founder Jack Ma for several years now. What's it like working with him, and what have you learned as a result?*

Daniel Zhang: We work very well together. Since joining Alibaba in 2007, I've worked very closely with him. While we have totally different personalities, we complement each other well. Jack is a visionary. He thinks about not only today and tomorrow but five and ten years from now, and that is what makes Alibaba different. I learned from him the importance of looking at the big picture. You need to have your feet planted on the ground and move forward solidly, but you also need to be forward looking. We look at opportunities not only for today but, more importantly, opportunities for the next generation and the coming decades.

Daniel Zipser is a senior partner in McKinsey's Shenzhen office.

Consumer goods industry

What got us here won't get us there: A new model for the consumer goods industry

COVID-19 is amplifying 12 trends that have been disrupting consumer goods for the past decade. Leaders will adopt a new model that gets their evergreen brands on the right side of the trends and scales up their small brands quicker. Together these changes will fuel the next generation of industry growth.

by Udo Kopka, Eldon Little, Jessica Moulton, René Schmutzler, and Patrick Simon

This article first appeared on McKinsey.com in July 2020.

After 40 years of outperformance enabled by a widely used five-part success model, the global consumer packaged goods (CPG) industry struggled to grow over the last decade. Why? Because 12 disruptive trends have diluted the old success model for growing mass brands. Now the COVID-19 crisis is amplifying many of these trends, triggering an industry imperative to change.

CPG players need to rethink their portfolio priorities and 'where to play' choices to increase their exposure to growing markets, channels, and sub-categories. These shifts will necessitate more dynamic resource allocation and greater use of mergers, acquisitions, and divestitures to improve portfolio composition.

CPG companies also need to adopt a new how-to-win model that reinvents marketing to focus on consumer relevance and builds new, largely digital commercial capabilities to grow with growing channels and markets, especially in emerging Asia. CPGs need to enable these new commercial capabilities with an evolved operating model that prioritizes consumer closeness and local decision-making in key markets, as well as intelligent productivity gains to fuel commercial investments.

Together, these shifts will help CPG players establish a contemporized virtuous cycle to replace the old model that worked so well for so long. The new model will help CPGs get their evergreen brands on the right side of the disruptive trends and help their small brands scale faster, fueling the next era of industry growth.

The rise and fall of the traditional CPG success model

The global CPG industry performed very well for a very long time, building many of the world's top brands. The industry generated the second highest total return to shareholders (TRS) across industries in the 40 years before the global financial crisis (GFC) of 2008–09—15 percent, topped only by the materials industry.

CPG value creation model for Western brands

This success owed much to a five-part model that fueled the growth of leading brands. Pioneered just after World War II, the model has seen little change since then. This model entails:

— *Mass-market brand building and product innovation,* generating stable growth and gross margins typically 25 percent above nonbranded competitors

— *Partnering closely with grocers and other mass channels to gain broad distribution* as the grocers grew

— *Building brands and distribution in developing markets* as consumers became wealthier, capitalizing on the top trend on the planet—rising wealth—that accounted for 70 percent of revenue growth in the CPG sector over the past two decades (and will continue to do so for the next decade)

— *Driving cost out of the operating model,* often through increased centralization of marketing, among other functions

— *Using mergers and acquisitions* to consolidate markets and enable organic growth post-acquisition.

This model created a virtuous cycle—strong brand equity and broad distribution generated higher margins that in turn allowed for more brand equity investment. Scale provided a critical competitive advantage.

The struggle to find growth

However, over the last decade, industry performance has faltered in terms of fundamentals and stock market performance. Economic profit[1]

[1] Economic profit is NOPLAT less cost of capital.

Zooming in on large US CPGs from 2017 to 2019, all of their organic volume growth and almost 90 percent of their value growth came from small and medium-size brands.

growth has nosedived. From 2000 to 2009, economic profit grew 10.4 percent per year; from 2010 to 2019, it dropped to 3.2 percent per year. Similarly, industry stock market performance went from outperforming the S&P 500 by 7.2 percentage points per year from 2000 to 2009 to underperforming by 2.8 percentage points per year from 2010 to 2019.

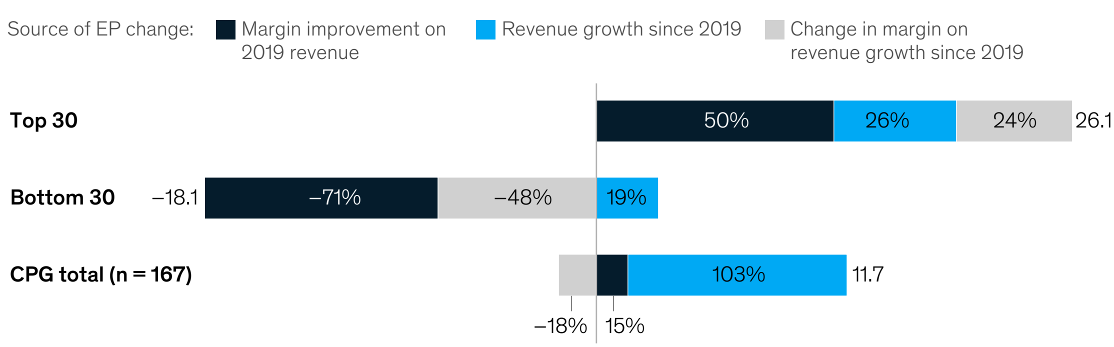
In more recent years, some players began pulling ahead of the pack in economic profit contribution. But margin, not growth, drove almost all of this improvement. In fact, for the top 30 CPG companies in absolute economic profit growth, margin expansion contributed twice as much as growth to value creation (Exhibit 1). Many of these players made major SG&A reductions emerging from the GFC and have sustained them since then—by 3.3 percentage points of sales since 2010.

The central problem is large brands, which are struggling to create unit growth. A closer look at the US market before COVID-19 is revealing. From 2017 to 2019, large brands (more than $750 million in revenue) in the US lost volume at the rate of 1.5 percent a year. At the same time, small brands grew

Exhibit 1

For the Top 30 CPGs, margin expansion contributed twice as much value as growth—50 percent, versus 26 percent.

Change in economic profit 2009–2019, $ billion



Source: McKinsey Corporate Performance Analytics; McKinsey analysis

1.7 percent, and private label grew 4.3 percent.[2] Zooming in on the large CPGs (more than $2.5 billion in US revenue), we see that all of their organic volume growth and almost 90 percent of their overall value growth came from their small and medium-size brands (less than $750 million in revenue), even though those brands contributed only 42 percent of 2016 revenues. Small brands (less than $150 million in revenue) especially outperformed: they contributed 50 percent of value growth, while contributing only 11 percent of 2016 revenues.

As a result, in recent years the leading brands in each CPG category have generated only 25 percent of value growth in US Nielsen-covered channels.[3] Meanwhile, small and medium-size brands captured 45 percent of growth, and private-label products captured 30 percent. This underperformance by leading brands varies by category, with household care performing best, but leading brands in all categories captured less than their fair share of growth (Exhibit 2).

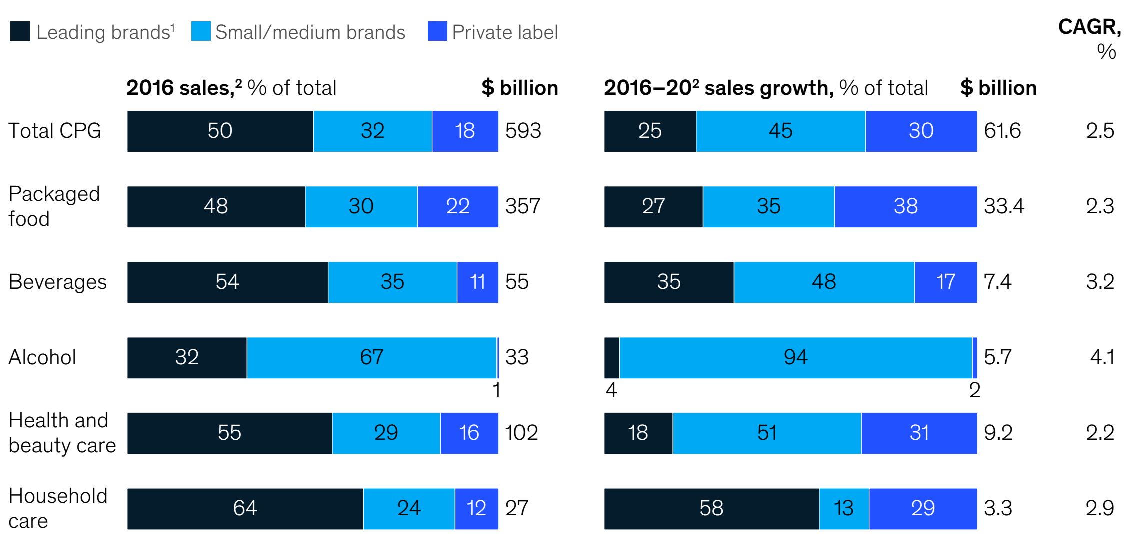
Industry performance mismatch with high market expectations

The market expects CPG leaders to overcome this growth challenge. We analyzed the valuations of 155 listed CPG companies. Their December 2019 aggregate market cap—chosen to avoid the distorting impact of COVID-19—suggests that investors expect significant performance improvements. Assuming constant margins, CPG players need to achieve one to 1.5 percentage points higher organic growth rates than they did in the last decade to meet investor expectations. Maintaining their recent growth rate of 2.6 percent risks an approximately 25 percent reduction in market cap (Exhibit 3).

Exhibit 2

In recent years, leading brands in each CPG category have generated only 25 percent of growth in US Nielsen-covered channels, despite being 50 percent of sales.

Sales growth across US Nielsen-covered stationary channels by type of brand (2016–20[2]), % of total



[1] Leading Brands defined as the top 3 brands by TTM 04/2016 Sales by sub-category (eg, whiskey, hair care), small / medium brands as remaining brands apart from Private Label.
[2] Includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores. Years refer to 12 months, ending in April of that year (eg, 2016 = 12 months from 05/2015 to 04/2016).
Source: Nielsen

[2] US Nielsen data includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores; *leading brands* defined as top three brands in each category, by 2016 sales.
[3] US Nielsen data includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores; *leading brands* defined as top three brands in each category, by 2016 sales.

Exhibit 3

Assuming constant margins, CPGs need to deliver ~1–1.5 percentage points higher organic growth than in the last decade to meet investor expectations.

Large CPG companies—aggregate market cap at different growth and margin scenarios,[1] $ trillion

■ Current valuation +/– 10%[2] ■ Momentum case (past trajectory) ■ Possible valuations at current margin/growth levels

Margin 2019 (13%)

Organic revenue growth, % (2020+)	11%	12%	13%	14%	15%	16%	
5.0%	3.1	3.5	4.0	4.4	4.8	5.3	
4.5%	2.9	3.4	3.8	4.2	4.6	5.1	
4.0%	2.8	3.2	3.6	4.0	4.4	4.8	
3.5%	2.4	2.8	3.2	3.5	3.9	4.2	Required CAGR 2020–30[3] (3.5–4%)
3.0%	2.2	2.5	2.8	3.1	3.4	3.7	
2.5%	1.9	2.2	2.5	2.8	3.0	3.3	CAGR 2009–19 (~2.6%)
2.0%	1.7	2.0	2.2	2.5	2.7	3.0	

EBITA margin, % (2020+)

[1]Based on DCF analysis using aggregated financial performance and assuming WACC of ~7.5% (D/E of 25%), tax rate of 24%, IC/Revenue ratio of 42% (based on last 5 years average), perpetuity growth beyond 10 years capped at 4%.
[2]Aggregate Market cap of $3.4 trillion as of Dec 31, 2019 (pre-COVID-19 impact).
[3]Assuming constant margin.
Source: S&P CapitalIQ, company reports, McKinsey analysis

Accelerating growth by ~40–60 percent is a tall order. To stay healthy and relevant to consumers, CPG companies must confront the challenge.

12 trends disrupting the traditional model

Why has the old success model stopped generating growth? Because 12 disruptive trends have battered the model over the last decade. Now COVID-19 is amplifying many of them (Exhibit 4).

Five of those trends are disrupting CPGs' traditional mass market brand-building. Digital media and the ubiquity of digital data are transforming how consumers learn about brands. Price sensitivity is skyrocketing in importance in the wake of COVID-19. In Western markets, what consumers value is shifting, with younger consumers seeking brands they see as special, different, and authentic. About half of Western consumers across age groups are prioritizing conscious eating and living, preferring purpose-driven brands that help them meet personal goals like reducing meat consumption. Small brands are rushing in to deliver on these brand values (although execution challenges during the COVID-19 crisis have held them back, growing at only their fair share, instead of outgrowing large brands).

Four of the 12 trends are transforming selling channels. E-marketplaces have experienced meteoric growth of 17 percent over the last five years, generating 65 percent of the growth among the top 150 retailers across the globe (and across all categories). E-marketplaces surged in grocery categories during the COVID-19 crisis, with Amazon's grocery business growing 45 percent in the US and 80 percent in the UK, according to Slackline. Meanwhile, discounters are continuing their steady rise, especially in Europe and some developing markets. As a result, grocers are squeezed and responding in ways that make them increasingly challenge trading partners. Now COVID-19 is driving foodservice market contraction—a major challenge, particularly for beverage players.

While developing markets will continue to account for 70 percent of consumer goods growth, the mix of geographies has shifted, with emerging Asia generating far more growth than other developing markets (representing about half of global private consumption growth over the next 10 years). Local competitors and digitization of the trade structure are key dynamics in emerging Asia.

Of course, all trends vary by market. Averaging can risk masking the intensity of trends in leading countries— for example, China for digital sales, South Korea for beauty regimen, and Germany for price and value. We advocate monitoring lead markets to see and seed the future in others.

See the "Twelve disruptive trends" summary table for a more complete trend analysis.

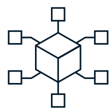
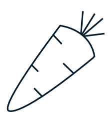
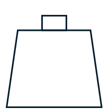
Exhibit 4

The old model stopped generating growth because 12 disruptive trends have battered the model over the past decade—now, COVID-19 is turbocharging many of them.

Moderate ■■■■■ very high

The old value-creation model	Disruptive trends	Trend impact: Past 10 years	Trend impact: Next 10 years	Disruption due to COVID-19
Mass-market brand-building and product innovation	1 Digital ubiquity (data, mobile, and the Internet of Things)	2	5	↑↑
	2 Importance of value/price sensitivity	4	5	↑↑
	3 The millennial and Gen-Z effect	2	4	→
	4 Conscious eating and living	3	5	↑
	5 The explosion of small brands	3	4	↓
Partnering closely with grocers to gain broad distribution	6 Meteoric rise of e-marketplaces	3	5	↑↑
	7 Steady rise of discounters	3	4	↑
	8 Mass-merchant squeeze	2	5	↑
	9 Foodservice challenges	2	3	New
Building brands and distribution in developing markets	10 Battle for emerging Asia	3	4	↑
Driving cost out of the operating model, often through centralization	11 Pressure for profit from activist investors	2	3	Jury's out
Using M&A&D to consolidate markets and enable organic growth post-acquisition	12 Rising competition for deals	3	3	Jury's out

Twelve disruptive trends

Old value-creation model	Disruptive trend	Key facts
Mass-market brand building and product innovation	Digital ubiquity 	• Digital (data, mobile, and the Internet of Things) has been revolutionizing how consumers and brands learn about and engage with each other • Under stay-at-home mandates triggered by COVID-19, digital engagement surged across all platforms
	Importance of value 	• After the GFC, consumer confidence did not rebound to prerecession levels until 2011 in Germany, 2014 in the UK and the US, and 2017 in China • COVID-19 will likely trigger a much deeper recession than the GFC. Currently, 65 percent of European consumers surveyed said they were very or extremely concerned about the economy
	The millennial and Gen-Z effect 	• US Millennials are almost four times more likely than Baby Boomers to avoid buying products from “the big food companies” and almost six times more likely to find newer brands “better or more innovative”[1]
	Conscious eating and living 	• Conscious eating and living are gaining traction, driven by three consumer desires—reduce meat consumption, contribute to sustainability, and accommodate dietary needs and preferences • 50 percent of UK consumers across the economy are conscious eaters, with 38 percent eating less meat, 30 percent factoring sustainability into food choices, and 24 percent accommodating a food intolerance or preference (with considerable overlaps)
	The explosion of small brands 	• Conscious eating is redefining what *healthy* means • Small brands have seen high growth, growing four times faster than large brands, 2018-2019, although they struggled with availability and execution during the COVID-19 crisis • Venture capitalists have provided $18 billion of funding to small CPG brands in the past five years • Large CPGs acquired small brands successfully in the last few years, often accelerating their growth and helping them over the $100 million scale barrier
Partnering closely with grocers to gain broad distribution	Meteoric rise of e-marketplaces 	• E-marketplace/online-to-offline (O2O) giants have generated 65 percent of the top 150 global retailers’ growth, growing at 17 percent, 2014–2019, versus grocers’ 0.8 percent • Three e-marketplace/O2O giants—Amazon, Alibaba Group, and JD.com—account for almost all of the growth • COVID-19 helped e-marketplace/O2O giants surge in grocery. Amazon grew its grocery business 45 percent in the US and 80 percent in the UK, according to Slackline • This disruption will accelerate as e-marketplace/O2O giants increase their geographic reach and move into brick-and-mortar

[1] McKinsey, “Millennial Survey,” 2019.

Old value-creation model	Disruptive trend	Key facts
	Steady rise of discounters	• ALDI and LIDL grew 6.7 and 7.1 percent, respectively, between 2013 and 2018 • Discounters typically grow to secure market share of 20 percent or more in each grocery market they enter
	Mass-merchant squeeze	• The rise of the e-commerce giants and the discounters is squeezing grocers and other omni-channel mass merchants • Together, the 76 largest mass players saw revenue growth of just 0.8 percent between 2014 and 2019 • This pressure is forcing mass merchants to become tougher trading partners, including participating in buying alliances, which accounted for 55 percent of retail value from multinational CPGs in Europe in 2019 and are projected to exceed 95 percent by 2025
	Foodservice challenges	• The COVID-19 crisis is triggering foodservice consolidation • The ongoing economic impact and increase in remote working will further challenge foodservice
Building brands and distribution in developing markets	Battle for emerging Asia	• China, India, and emerging Asia–Pacific will generate more than 50 percent of the world's growth in real private consumption, between 2019 and 2029. Yet they account for only 20 percent of private consumption today • Within a decade, 75 percent of Chinese households and almost 60 percent of Indian households will be part of the consuming class • The growth rates of other developing markets have nearly halved since 2009 so they will contribute only 12 percent of real private consumption growth between 2019 and 2029 • The US remains a key market, generating 20 percent of global growth (the bulk of the 35 percent developed market share of growth) • Channels in developing markets are evolving differently than they did in the West, e.g. emerging Asia's fragmented trade is digitizing
Driving cost out of the operating model	Pressure for profit from activist investors	• Activists ran more than 110 campaigns per year against CPG players between 2016 and 2019 increasing attention to SG&A industry-wide • Activist investors encouraged some short-sighted choices from which the industry is still recovering
Using M&A to consolidate markets and enable organic growth post-acquisition	Rising competition for deals	• Competition for deals has sustained high EV/EBITDA multiples in CPG of 10.1x–11.8x since 2013 • Despite the COVID-19 crisis, deal competition will increase as large assets grow scarce and private equity firms sit on an estimated $1.6 trillion in dry powder

Tough questions and strategic choices

Before the COVID-19 crisis, major CPG companies were evolving toward a new model. They were sharpening their execution of the old value creation model, experimenting with ways to own the explosion of small brands in their categories, and pulling the lever of productivity more than ever to meet investor expectations.

Then the pandemic hit. Grocery volumes surged 20 percent with pantry loading and then settled at 5 to 10 percent, while restaurants remained closed or tightly restricted. Through this period, large CPG companies mobilized their supply chains and concentrated on top lines, while small players struggled to pivot. Further, 15 percent or more of consumers changed their primary grocery store, generating a shock to loyalty and lots of forced trial. This has created a powerful opportunity for brand leaders to get closer to the consumer, while reasserting the benefits of scale in the supply chain and key account relationships. But the crisis is also accelerating consumer demand for value and reliance on digital. All of this constitutes a call to action for the industry.

CPG companies need to confront these challenges by rethinking their "where to play" growth strategies across categories and brands to get more exposure to growing markets channels and brands. And they need to shift much faster to a new 'how to win' model that embraces digital marketing, sales, and operations, creating a new virtuous cycle that works for today's consumers and trade. We outline questions to ask and moves to consider below.

Portfolio and category strategies

For each of our category franchises, where is the growth, and how well positioned are we to capture it with our current mix of evergreen brands and small brands, especially in the shadow of COVID-19? How are consumers changing? How are channels changing? How well-suited are our competitive advantages to these changes? Therefore, where should we play? In particular, should we participate in the value segment or allow the "good enough" portion of our categories to grow without us? And do we need to divest any brands because they no longer fit our growth requirements or our business model? What capability improvements and what big bets, including true business model change, could unlock a new wave of growth for us?

Great portfolio and category strategies start with two inputs: a privileged view of what is happening with the consumer and the market and a deep understanding of the company's competitive advantages. With these in hand, a company can determine how well-suited its current evergreen brands and small brands are to capturing growth and therefore what strategic goals to set for them. The company can then identify what new business models, external partnerships, and M&A agendas could generate exciting new growth.

Evergreen brand growth strategies

How relevant are our evergreen brands to growing consumer segments, especially those under 35? What will it take to get our evergreen brands on the right side of consumer and channel trends and accelerate their growth?

Many CPG companies have been renovating the brand equity of their large brands, imbuing them with more purpose, more originality, and more relevance. This is the right place to start. Particularly in the context of COVID-19, delivering on the brand's promise is necessary but not sufficient. Consumers, especially younger consumers, want brands that understand them and share their values. They also want to know that the brand is virtuous on local community contributions, equitable commerce, and environmental performance. Trust and purpose matter more than ever.

Of course, superior functional performance is also essential for evergreen brands, and the bar keeps rising as private-label contract manufacturers mature. Evergreen brands must obsess over their functional performance across all consumer occasions, using innovation as needed to retain leadership.

Getting evergreen brands on the right side of marketing and sales trends is also vital. Marketing must be tailored by audience, delivering relevant messages through relevant channels in a granular way, while the product line of the evergreen brand remains appropriately streamlined. Evergreen brands must also embrace high-growth sales channels and retail formats, even when they require a different commercial model than grocery. Channel strategies will need to be even more customized to each country and category trend. For example, in Brazil, the cash-and-carry format should prove resilient in the aftermath of the COVID-19 crisis. In all cases, evergreen brands must shape the execution of their categories in their relevant channels.

Above all, evergreen brands must lead in consumer closeness, to guard against small competitive brands popping up in segments left unattended and against retailers offering good enough alternatives at lower prices.

Small brand growth strategies
What will it take to help our small brands achieve scale rapidly? How can we make small brand acquisitions successful?

Driving the explosion of small in your categories is an exciting prospect, offering the potential to extend category leadership with concepts that appeal to engaged niches and can command a premium. Major CPG companies are getting the hang of it. Small US brands acquired by large CPGs grew faster than other small brands, between 2018 and 2020. But many small brands struggle to get over the $100 million barrier so acquiring the right challenger brands is not easy. Would-be acquirers should look for the three hallmarks of a truly scalable proposition—longevity (fit with a growing lifestyle or consumer mindset), breadth (a natural direction for expansion into adjacent categories, channels, geographies, or needs), and momentum (loyalty that secures high returns through repeat purchase or word of mouth).

Acquirers can scale a small brand over time by guiding, intervening in, or integrating it, but they must act at the right time and remember why small brands often initially succeed on their own. On the journey to scale, small brands need to win on their proposition, be disciplined on commercial levers, and build the backbone for scaling. The small brand proposition is usually the "sparkle"—often predicated on new, niche consumer insights or a business model that big brands typically lack the authenticity to offer. The scaling risk lies in expanding beyond the core too early, before a small brand has earned the right to offer the adjacency.

Successful stand-alone small brands are very disciplined and very careful about spending. Small brands usually market efficiently with the core consumer in mind. As they grow, they leverage

The new model uses digital to move away from mass marketing and sales and toward targeted commercial execution.

their community and loyalty to "export" the brand. They also tend to focus on a key channel to deliver and delight the core audience before expanding distribution points to increase purchase frequency. An acquirer can open the door to a few thoughtful channel expansions, as well as guide the small brand in pulling commercial levers (i.e., pricing and promotional optimization) before scale takes hold, keeping the brand efficient.

The supply chain and the operating model are often a secondary focus for a small brand but essential for scaling. An acquirer can provide supply chain instruction or even integration support to help the small brand build a strategic and responsive supply chain. This is especially helpful in categories with long lead times, highly regulated environments, or fluctuating raw material costs.

The new model

To execute these category and brand growth strategies, CPGs need to adopt a new model—a new "how to win"—that looks quite different from the old model. The new model continues to leverage scale advantages in marketing spend, distribution, supply chain, and back office but uses digital to move away from mass marketing and sales and toward targeted commercial execution. The new five-part model, which requires building or strengthening 16 individual capabilities, looks like this (Exhibit 5).

Relevance-led brand building, innovation, and marketing

Relevance-led brand building is vital for both evergreen brands and small brands. Most CPG companies need to do much more to sharpen their consumer targeting, enabled by new digital media. This targeting needs to cross all touch points and include personalized point-of-sale marketing, which remains very underdeveloped today. Insights from the vast amounts of data that consumers create then need to loop back into innovation priorities and results, maximizing the brand's relevance to micro-segments and micro-occasions, while keeping the product line focused on an efficient core.

Exhibit 5

Getting on the right side of trends: Revamping 'where to play' and 'how to win.'

Degree of change versus the old model: Extensive Moderate

Where to play

Portfolio, category and brand strategies

Portfolio strategy
- Category priorities
- M&A&D

Category strategy
- How consumers, markets and channels are changing
- Micro-pockets of growth combining category evolution, consumer sentiment, needs and occasions
- Your competitive advantages
- Subcategory, market and channel priorities
- Big moves, e.g. new segments, new business models

Brand strategy
- Brand promise and positioning
- Subcategory, market and channel priorities

How to win

The new model	Required capabilities
Relevance-led brand building, innovation and marketing	•Occasion- and purpose-led portfolio, innovation and design •Data-driven marketing
Partnering with all growing channels and embracing digital sales	•Precision revenue growth management •E-marketplace management •Building omnichannel and DTC businesses •Digital route-to-market and customer contact
Building brands and distribution in developing markets	•Local success models
Evolving the operating model to excel at local consumer closeness and ever greater productivity	•Fitter, flatter, faster organization •Agile sprints to accelerate innovation and change •Next-generation design and procurement •Intelligent supply chain •Tech overhaul •Back-office automation •Agile budgeting and resource allocation
Using programmatic M&A&D to acquire small brands and capabilities and to divest low growers	•Programmatic M&A&D for small brands and capability •Divestment of low-growth brands

Partnering with all growing channels and embracing digital sales

While grocers will remain CPG companies' most important and strategic trading partners in most markets, CPGs also need to ensure that they achieve pervasive distribution of their evergreen brands, which requires embracing many channels, including e-marketplaces. Small brands need to be present in their best-fit distribution channels. Therefore, most CPGs need to strengthen four digital-driven commercial capabilities.

Precision revenue growth management (RGM). Leading CPG players unlock the next growth curve by linking the core levers of RGM—pricing, assortment, promotion, and trade investment—to the company's occasion expansion and activation strategy. Precision RGM is powered by advanced analytics tools that automate key analyses at a very granular level and enable simulation and foresight.

E-marketplace management. Maximizing success on these platforms without triggering cannibalization of more profitable sales requires appropriate, tailored messaging and assortment at the point of sale. CPGs need to build developer teams that produce the necessary assets (pictures, videos, and key words) and drive technical execution, day in and day out. These teams need to be fully integrated with the business and prioritized as a critical capability required to maximize growth.

Building omnichannel and D2C businesses. CPGs need to excel at omnichannel category management, setting the goal of overtrading versus each retailer's brick-and-mortar business, particularly given the expected two to three percentage point share gain that online will enjoy in most markets post-crisis. Direct-to-consumer (D2C) businesses are commercially viable for only select CPG propositions—namely, those with an average basket and purchase frequency high enough to justify customer acquisition costs and make per-order economics viable. Categories like pet care and non-OTC consumer health offer abundant opportunities. For other categories, D2C propositions may still be worthwhile to acquire proprietary consumer data and create a test-and-learn opportunity.

Managing data for proprietary insights. CPG manufacturers must become experts on retailers' big data in order to keep their seat at the table. They must demonstrate expertise in big data analytics, insight generation, and ROI tracking of investments, particularly for e-marketplaces since these retailers often do not value traditional CPG category management.

Building brands and distribution in developing markets

Participating in developing markets of course requires deep local consumer understanding. Companies need to rebuild entrepreneurial, dedicated local organizations that can execute impactful global marketing campaigns in locally relevant ways.

CPG companies also need to evolve their routes to market as the trade changes. In emerging Asia, e-marketplace and online-to-offline (O2O) giants will continue to lead, while digital enablement of the fragmented trade will strengthen that format, leaving less room for Western-style modern trade.

For CPG players, early adopters of digital-led route-to-market models will have a clear advantage, both in shaping point-of-sale service level expectations and in leveraging the power of analytics. The value proposition to the fragmented trade will be increasingly customized, enabled by advanced recommendations on assortment and pricing that require different back-end processes in CPG commercial teams.

Evolving the operating model to excel at local consumer closeness and productivity

Historically, some CPG companies went too far in pursuing a global one-size-fits-all model and lost ground to more locally relevant competitors. Going forward, CPG players need to reinvest in local talent and decision rights in priority growth markets and use them as lead markets for understanding consumers and channels in the region or sub-region.

The local GM should own the game plan for winning in the market.

Companies at the forefront of implementing this more unbundled operating model have, for example, abandoned traditional paradigms of how to organize for innovation. Instead of driving innovation out of global R&D centers, they identify innovation needs by local market, with employees at all tenures having nomination rights. Then they form a cross-functional team within days, fast-track funding, and, with the help of global R&D capabilities pulled into the process, develop a marketable product in weeks, rather than years.

This operating model uses technology and digitizes wherever possible, from automating standardized tasks in HR, finance, and IT to supporting the decision making of signature roles, such as equipping brand managers with KPI cockpits and consumer insights dashboards.

Great operating models are adept at promoting change. We advocate establishing a high-profile, institutionalized sprint process that identifies, resources, and sponsors new capability-building and other priorities across the business in short-burst cycles. One CPG company, for example, identified mission-critical tasks in marketing and organized cross-functional teams in six-week sprints around each task. Coupled with senior sponsorship and a "fast-track removal of barriers" spirit, all the teams completed their tasks, which otherwise might have taken years. Such success makes it easy to rally the rest of the organization around the coming change and create a pull, rather than a push, transformation.

Operating models also need to unlock the next wave of productivity. We see several opportunities.

Next-generation design and procurement. Product design needs to get closer to what the consumer values and reduce all other costs by modularizing, tearing down, and benchmarking every element in new designs. Even leading CPG companies still lag behind industries like automotive and medical products in embracing design-to-value. Indirect procurement often offers another substantial savings opportunity. Most CPGs can achieve savings of three to seven percentage points on their addressable direct and indirect procurement base.

Intelligent supply chain. Today it is possible to realize the aspiration of an intelligent supply chain in which an integrated planning process takes relevant data from the demand side and turns it into reality on the supply side. Success requires harnessing digital data throughout the value chain and using it in an integrated, automated corporate planning process. A major benefit of this shift is the ability to move from monthly to more frequent sales and operations-planning cycles that maximize sales, while reducing obsolescence and working capital.

Tech overhaul. Tomorrow's supply chain must operate in real time and with insufficient information to enable cost reduction, resilience, flexibility, and traceability, especially post-COVID-19. Most mature CPG players need to jettison their legacy IT set-up, taking a zero-based approach and moving into a cloud scenario focused on customer-driven processes built for machines talking to each other, not humans emailing Excel spreadsheets.

Back-office automation. In the past 20 years, SG&A cost reductions came from doing the mess for less, making operations cheaper but not better. Now is the time to overhaul the processes built for the ERP environment of the 1990s and use emerging technologies like intelligent automation and artificial intelligence to modernize the back office, creating a service-oriented, low-touch/low-code environment to democratize automation, analytics, and artificial intelligence.

Agile budgeting and resource allocation. Our research shows that top performers reallocate 2 to 3 percent of resources per year, removing unproductive costs and channelling funds to priority initiatives. The zero-based budgeting processes that many CPG companies have implemented make this ambitious goal more achievable than in the past.

Programmatic M&A&D

CPG companies have been using M&A&D extensively to pivot their portfolios toward growth and add capabilities rapidly. In the last decade, leading CPGs players turned over their portfolios at more than twice the rate of other large listed firms.[4]

The strongest CPG players will continue to develop the skills of serial acquirers adept at acquiring both small and large assets and at using M&A&D to achieve visionary and strategic goals—redefining categories, building platforms and ecosystems, scaling quickly, and accessing technology and data through partnerships. The most successful players employ a programmatic M&A approach focused on snapping up challengers, rather than market consolidation or expansion into adjacencies (8.3 percent total shareholder returns between 2013 and 2018, compared with 6.1 percent and –7.8 percent, respectively).[5] These players often complement their M&A&D programs with incubators or accelerators for small players, that, at their best, leave ample time to fully understand the success drivers of the brand and help the organization scale the brand without overburdening it with inflexible operating procedures.

After a period of disruption intensified by the COVID-19 crisis, the CPG industry is entering a new era. CPGs that prosper in the 2020s will make where-to-play choices that strengthen their portfolios and get their categories and brands on the right side of the disruptive trends. They will also adopt a new how-to-win model that focuses on relevant consumer marketing and selling across growing channels, and they will embrace an operating model that prioritizes consumer closeness and intelligent productivity gains to fuel commercial investments. These shifts will help industry leaders unlock growth with brands and business models, old and new.

4 McKinsey analysis.
5 McKinsey, "The next wave of consumer M&A: Executing for value," October 21, 2019 (median TRS data refers to programmatic M&A approach only).

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Consumer organization and operating models for the next normal

Many consumer-goods companies and retailers have risen to the challenges presented by the pandemic. Seven core practices can help them keep what has worked and prepare for what lies ahead.

This article was written collaboratively by the McKinsey Consumer Goods and Organization Practices, groups that span all of our regions and include: Ayush Agnihotri, Bryan Logan, Kristi Weaver, Oren Eizenman, Kate Lloyd George, and Lauren Ratner.

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The COVID-19 pandemic is posing staggering health and humanitarian challenges.[1] As the crisis evolves, companies must act on multiple fronts to protect their employees, customers, supply chains, and financial performance. Retail and consumer-goods sectors have been particularly affected, with frontline employees directly at risk and companies struggling with demand that is either rapidly evaporating or surging well past the available supply.

These most trying of circumstances have forced organizations to adapt quickly. In the process, many have achieved what they had aspired but failed to deliver for years. Decisions are made faster. Innovation cycles have dropped from months to days. Working remotely, previously a benefit offered to a portion of workers at some companies, is now an imperative for most employees. Companies are putting a greater emphasis on employees' physical and mental health than ever before, and they're celebrating leadership capabilities that weren't considered critical before the crisis.

These shifts occurred out of necessity—and, without thoughtful action, many of the recent changes are likely to revert over time to more traditional approaches. Leading companies will use this moment as an opportunity to rethink and reset their operating models for the future.

The seven shifts of the next normal

As companies reconsider and reconfigure their operating models, they need to be sure to underpin them with seven core practices that will define the next normal[2] (Exhibit 1).

1. Reset of operating model and rhythm based on fewer (and bigger) priorities

In the past few weeks, we have seen a sharper focus on top priorities, while less critical initiatives have been paused or discontinued altogether. A recent McKinsey survey of more than 100 executives at consumer organizations[3] revealed a desire for this sharpened prioritizing to continue and permeate into the next normal. As the fight-or-flight instincts triggered by the crisis relax, companies will be tempted to return to more familiar modes of employee engagement.

Sustaining the type of focus and strategic clarity we see today will require deliberate process changes and leadership commitment. The most focused companies use a variety of practices to align their organizations with a clear set of priorities. One such practice is having disciplined management meetings, including structuring the executive-team calendar to explicitly support strategic priorities. Organizations are also establishing working norms that ensure the management team's time together is focused on major decisions, avoiding tactical discussions and leaving ample time to ensure team alignment with company priorities.

Most companies also find that frequently—and formally—revisiting strategic priorities, a necessity during the COVID-19 crisis, is beneficial. This review can take the form of quarterly executive-team check-ins to assess existing initiatives and to determine whether to accelerate, evolve, or stop them or to address more structural elements, such as shifting from a three-year strategic-planning process to a more dynamic resource-allocation model.

Finally, aligning with fewer (and bigger) priorities may also enable an organization to reset organizational and operating structures. Narrowing down priorities can afford organizations a chance to realign their business segments with the top priorities, rather than with more traditional category or geographic segments, by elevating

[1] See Matt Craven, Mihir Mysore, Shubham Singhal, and Matt Wilson, "COVID-19: Implications for business," April 2020, McKinsey.com.
[2] See "The Next Normal" article series, at McKinsey.com.
[3] McKinsey Retail and Consumer Goods Bold Moves Survey. One hundred executives at US consumer-goods and retail companies with at least $2 billion in revenues were surveyed on the organization and operating-model implications of COVID-19. The survey was in the field the week of April 6, 2020.

Exhibit 1

New behaviors can evolve into the next normal for organizations.

What organizations have shown	Aspirations for the next normal
1. Rapid reprioritization	Reset of operating model and rhythm around fewer (and bigger) priorities
2. Management of cost to maintain liquidity	Comprehensive cost reset
3. Real-time innovation in digital channels	Significant resource distortion for must-win capabilities
4. Experimentation with remote workforce	Acceleration to the flexible workforce of the future
5. Reengagement with employees	Changed employee value proposition
6. Faster decision making	Sustained metabolic rate and speed of decision making
7. Resilient leadership during crisis	Heightened focus on leadership development

key brands, countries, or information to the CEO in a much more deliberate way. Moreover, it may allow the senior leadership team to incorporate new roles, both permanent and temporary, that reflect the new priorities: M&A, business building, and transformation.

2. Comprehensive cost reset

To recapture pre-COVID-19 margins, many consumer-facing organizations will need to reset their cost structures (Exhibit 2). Disrupted categories (for example, white goods and apparel) are suffering, but even surge categories such as grocery will be adversely affected in the longer term because of shifting consumer sentiment and models of consumer interaction, such as curbside pickup.

Our preliminary impact assessment found that retailers that don't proactively adapt to changing conditions could see their margins fall 200 to 400 basis points because of increased labor and fulfillment costs. The short- to medium-term impact of shifts in costs and revenues is equivalent to 20 to 30 percent of general and administrative costs. This reduction doesn't include the additional investment necessary to build capabilities that will enable growth.

The story for consumer-goods companies is more nuanced; some categories have flourished thanks to near-term stock-ups while other, more discretionary consumer goods have been affected adversely. Although the margin implications will vary by subsector, the need to invest in new and emerging capabilities, such as digital, data, and analytics (DD&A), is universal. Focused priorities and streamlined decision making naturally create an opportunity to reset the cost structure.

Exhibit 2

Retail cost structures need to be revised postcrisis.

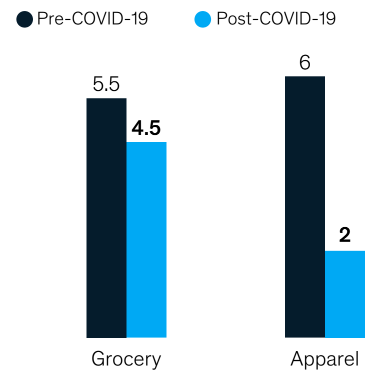
Profit and loss headwinds

Top line	−	Contraction for discretionary categories; return to normal varies based on economic response and virus containment
Pricing and promotions	−	Promotional intensity fueled by declines in consumer sentiment and spend
Shipping and handling	−	Accelerated shift to online and lower-margin fulfillment models
Labor costs	−	Swing from historically low to high unemployment, although wages likely to continue to rise
Occupancy	− +	Store closures and bankruptcies likely to put continued pressure on lease rates and terms, but deleveraging could continue as sales shift online

Profit and loss tailwinds

Top line	+	Demand surge in some nondiscretionary categories; return to normal varies based on economic response and virus containment

Unmitigated EBITDA[1] impact for retailers, %



Many headwinds already in place before COVID-19 are now accelerated

[1] Earnings before interest, taxes, depreciation, and amortization.

Cost resets are known commodities to most established organizations, but the coronavirus offers a twist on the traditional approach. Physical footprints will change to accommodate people coming back to work. Physical-distancing protocols will likely need to be put in place, at least in the near term, to make sure that employees feel safe. New flexible work options will have immense HR and IT implications. These and other changes will compel companies to adapt their organizational structures and operating models.

3. Significant resource distortion to must-win capabilities

Many of the shifts in recent months represent a substantial acceleration of consumer trends that had already been in progress for some time. For instance, online shopping is up by 20 to 70 percent since the pandemic began, and supply chains are adapting rapidly. Store economics have been strained for some time, and we expect store footprints to continue to shrink. In the next normal, many stores could become nodes in a retailer's supply chain.[4] These stores could also increasingly reflect the tastes of local consumers as they adapt product, pricing, and promotions to each market. Finally, the international spread of the coronavirus has accelerated the premium on flexibility in supply chains, including in partner terms and sourcing (particularly nearshoring).

We have observed other shifts that are much newer but likely to be similarly long lasting. For example, the unprecedented focus on hygiene during the crisis has prompted updated hygiene protocols and a rise in single-use plastics and wipes. These changes are having an impact on sustainability and are forcing companies to innovate ecofriendly alternatives. Physical-distancing protocols also have prompted a rush to adopt contact-free payment and fulfillment models: about 30 percent of consumers intend to continue using self-checkouts

[4] Praveen Adhi, Andrew Davis, Jai Jayakumar, and Sarah Touse, "Reimagining stores for retail's next normal," April 2020, McKinsey.com.

after the crisis, and companies have innovated new delivery and pickup models. The final, but perhaps most troubling, shift is the shock to customer loyalty. Up to 40 percent of consumers have switched stores and brands during the crisis, and many may choose to keep their new habits.

Retailers and consumer-goods companies should ensure that they are strategically positioned to capture growth from these significant trends. Doing so may require investing further in existing capabilities such as e-commerce or innovation or in a new set of capabilities—for example, flexible supply chains, omnichannel sales capabilities, and more accelerated DD&A. It may also include rethinking marketing strategy, capabilities, and spending to better engage with changing consumer sentiments and habits. Organizations may consider pursuing M&A to rapidly gain priority capabilities: the environment is changing quickly, and winners will be out in front.

An average retailer allocates about 6 to 9 percent of its total resources to e-commerce, DD&A, and flexible supply chains. In consumer packaged goods, the number is similar—about 5 to 7 percent of resources. However, according to our recent survey of retailers and consumer companies,[5] respondents believe they will need to allocate two to three times more than their current level of resources to increase these capabilities in the future (Exhibit 3).

4. Acceleration to the flexible workforce of the future

The COVID-19 crisis has dramatically increased experimentation with flexible workforce models. Use of video-conference applications has risen by a factor of five to seven, and organizations have become more adept at working remotely. Talent exchanges are being created to address the imbalances between labor supply and demand by, for example, connecting disrupted retailers and consumer-goods organizations that have furloughed or laid off employees with companies that are looking to hire workers quickly. One such exchange, powered by Eightfold.ai and FMI, was launched in early April and, within just two weeks, listed more than 600,000 job openings in the food industry. Some companies have internal talent exchanges: one Chinese cosmetics retailer used one to reposition its store workers to be online influencers.

Exhibit 3

Executives think important capabilities need greater investments.

Top 3 capabilities considered most important in the next 12–18 months[1]

E-commerce or omnichannel	Upgraded online-merchandising capability, strong social-commerce presence and ability to interact with customers when/where/how they want, differentiated channel strategy, cross-channel inventory and customer management
Digital, data, and analytics	Advanced analytics and machine learning, big-data management, social media listening and response; personalized digital marketing and loyalty
Flexible supply chain	Omni–supply chain with ability to route product in 2-speed model, last-mile delivery, "next product to make" adaptability, nearshoring; partner terms

Today, these capabilities[2] **are limited**

- **6–9%** of a typical retailer's FTEs[3]
- **5–7%** of a typical consumer-goods company's FTEs

40% of peers believe they need to increase these capabilities 2–3×[1]

[1] Responses to "Which new capabilities do you expect to be most important to your organization in the next 12–18 months?" Top 3 responses allowed, so figures do not sum to 100.
[2] Considering average number of FTEs in retailer's or consumer-goods company's e-commerce, digital, analytics, and supply-chain functions (for supply chain, considered flexible, strategic, analytical omni-resources only).
[3] Full-time equivalents.

Source: McKinsey Commercial Excellence Benchmarking Survey, 2019; McKinsey Retail and Consumer Goods Bold Moves Survey, April 2020 (n = 100); company reports; McKinsey analysis

[5] McKinsey Retail and Consumer Goods Bold Moves Survey, April, 2020.

In the longer term, we will likely see two major developments. First, a so-called talent-anywhere strategy, with teams consisting of members across locations, could become increasingly common and allow employers to strengthen capabilities in geographies where they have been difficult to build. For example, we mapped the population of data scientists across the United States and found that nearly 70 percent of the headquarters for the top 100 retailers and top 100 consumer-goods companies were more than 50 miles from the nine largest concentrations of data scientists (Exhibit 4).

Second, to load-balance peaks and troughs, new talent marketplaces will emerge across functions to enable labor sharing by companies that don't compete with one another. This development may also establish a more standardized "certification" among retailers and consumer-goods companies for some common roles (such as cashier, stocker, line manager, and distribution coordinator), potentially reducing the talent-recruitment burden for HR.

Last, the increased use of the gig economy for specialized labor, such as designers, could reduce the need for in-house niche expertise or large centers of excellence. Many retailers, for example, are rethinking their large in-house creative agencies.

5. Changed employee value proposition

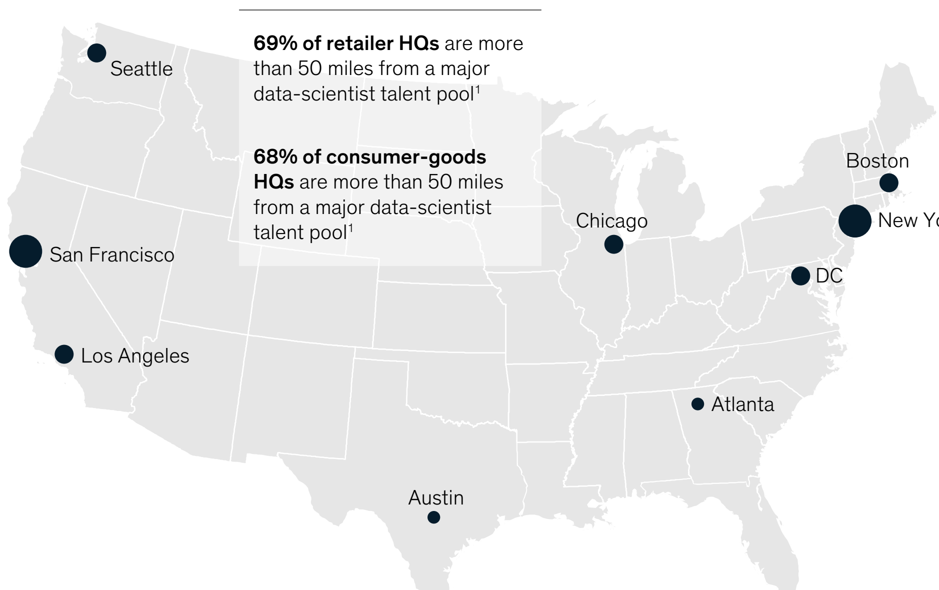
The COVID-19 crisis has changed the employer-employee dynamic. Recent events focused both parties on employee benefits (for example, health insurance and sick leave), protective measures (such as personal protective equipment), and the new norm of remote working.

While this focus will, with time, recede, it is possible that consumer expectations for how employees treat their talent will remain altered. Existing safety protocols may be expanded as personal

Exhibit 4

Talent centers don't overlap with consumer HQ locations (data-scientist example).

Top 9 US cities for data-scientist population



[1] Percentage of top 100 US retailers and top US consumer-goods companies.

Source: Stores.org; Consumer Goods Technology; Talent Intelligence; McKinsey analysis protective equipment becomes table stakes for many roles. Employees shocked by the high and rising unemployment rate will look for employers to provide opportunities for them to retrain in a lost-cost, online way. Employees in critical roles may be well positioned to demand that the expanded benefits they were offered during the crisis lockdown (for example, more generous sick-leave policies and enhanced medical benefits) be maintained.

That said, these benefits and improved working conditions come at a price—and most consumer companies will be keeping a close eye on their sales, general, and administrative costs over the coming months, if not years. The acceleration to a more flexible workforce may generate efficiencies that enable this changed dynamic.

6. Sustained metabolic rate of decision making

We have also noted the emergence of expedited and more focused decision making across consumer organizations. In our survey, more than 80 percent of executives said that decisions during the COVID-19 crisis are being made faster than before the crisis. Respondents also revealed that major decisions, such as closing stores or exiting a business unit, are requiring far fewer meetings: almost two-thirds require five meetings or fewer compared with one-quarter before the crisis (Exhibit 5).

While the need for accelerated decision making is obvious during this trying time, the ability to sustain such speed is something that companies have struggled with for years. In addition to determining the right governance to continue to make decisions at pace, companies must also establish the infrastructure to communicate and implement them in a thoughtful way.

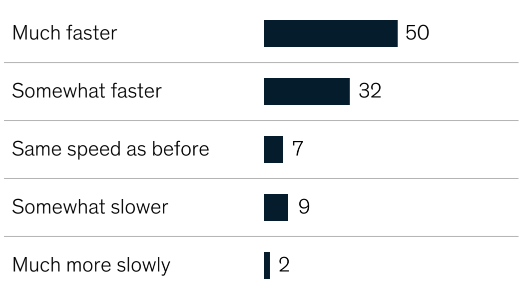
One way to help maintain this practice is by categorizing decisions and speeding up those

Exhibit 5

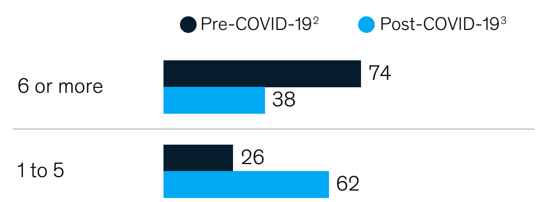
Focus on decisions, not meetings: Major decisions are being made faster during the crisis.

McKinsey CPG Retail Survey; n = 100 executives

Change in time required to make major decisions,[1]
%



Number of meetings required to reach a final decision,
%



"Cross-functional communication has vastly improved with increased collaboration and quicker decision making across functions."

"It absolutely made the team more agile, and decisions are now taken with much less time deliberating."

[1] Response to "What has been the change (compared to pre-COVID-19) in the time required to make major decisions (eg, exit or enter business categories, opening or closing stores, something relatively important for your business)?"
[2] Response to "Think about a major decision you were involved in supporting in 2019 (eg, organization decisions, exit or enter business categories, opening or closing stores, or something relatively important for your business). How many meetings were required to reach a final decision?"
[3] Response to "Think about a major decision you were involved in supporting since the COVID-19 crisis began in mid-March. How many meetings were required to reach a final decision?"

Source: McKinsey Retail and Consumer Goods Bold Moves Survey, April 2020 (n = 100) that need to be made quickly and paying more attention to those that matter most or need careful handling. Some leading companies determine the level of impact (positive or negative) at stake and the frequency each decision is made (and therefore the familiarity of the decision). With this approach, organizations can delegate lower-impact decisions, which often accelerates their execution, and focus leadership time on the big bets, which frequently require time-consuming, cross-functional coordination.[6]

Another approach is to think about how to build a minimal viable product (MVP) for different types of decisions. Many companies have done this throughout the crisis without even realizing that they were doing it. Retailers have focused on MVPs for store reopenings, and consumer-goods companies have replanned and rebudgeted the year (which normally takes weeks or months) in days.

Using both a decision framework and an MVP mindset will help consumer organizations to sustain the metabolic rate and speed of decision making they have had during the crisis.

7. Heightened focus on leadership development
The crucible of COVID-19 is highlighting leaders who are stepping up in new ways—as well as revealing unexpected gaps in leadership. In these extraordinary times, an intuitive leader may often be more effective than a tenured one, since a reliance on experience and traditional skills may be insufficient. The best leaders can:

— be empathetic—and open to empathy in return

— shift their management style to enable instead of "command and control"

— demonstrate decisiveness amid uncertainty

— be a role model of deliberate calm and bounded optimism[7]

As companies restart and settle in to the next normal, they should aim to create more opportunities for leaders to make rapid, high-stakes, and cross-functional decisions as part of the normal operating model. Organizations should identify individuals in their leadership pipeline who may fall short in the next-normal operating model. Should any succession plans be reconsidered in light of COVID-19? How could leaders benefit from peer-to-peer coaching?

Putting it all together

When all of these trends are viewed together, it's clear that this crisis has required, and will continue to require, companies to make big and bold changes. The recent pace and depth of change have demonstrated what's possible; companies will need to continue to push beyond the way things have been done in the past, but first they must cement the positive changes they have made since the onset of the pandemic.

By restructuring their organization to focus on the newly created priorities, modernizing their operating models to account for remote working and faster decision making, and shifting routines and rituals to bring value to shareholders, customers, and employees, leading companies will find ways to emerge from the COVID-19 crisis stronger than they were before. Such opportunities do not present themselves often, and organizational leaders need to act now to prepare for the next normal—which, before we know it, we'll all be living in.

[6] For more, see Aaron De Smet, Gerald Lackey, and Leigh M. Weiss, "Untangling your organization's decision making," *McKinsey Quarterly*, June 2017, McKinsey.com.
[7] Jacqueline Brassey and Michiel Kruyt, "How to demonstrate calm and optimism in a crisis," April 2020, McKinsey.com.

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The next normal in consumer: Implications for Consumer Goods M&A

Lessons from the global financial crisis teach us that consumer-goods companies should consider an active approach to M&A, adapted to the current context, to emerge stronger in the next normal

This article was a collaborative, global effort by Harris Atmar, Sara Hudson, Anish Koshy, Stefan Rickert, and Rodrigo Slelatt

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COVID-19 poses staggering health and humanitarian challenges.[1] In this rapidly evolving crisis, companies must act on multiple fronts to protect their employees, customers, supply chains, and financial results. All consumer sectors will feel the economic impact of COVID-19. This impact is likely to reshape short- and long-term M&A activity, as investors and organizations explore the implications and reassess how best to shape their business and deploy and/or shore up capital. To understand how Consumer Goods M&A may evolve, we draw on lessons from the global financial crisis (GFC) of 2008–2009 and explore the impact of trends in the consumer sector that COVID-19 has created, accelerated, or reversed.

M&A in the consumer goods sector before COVID-19

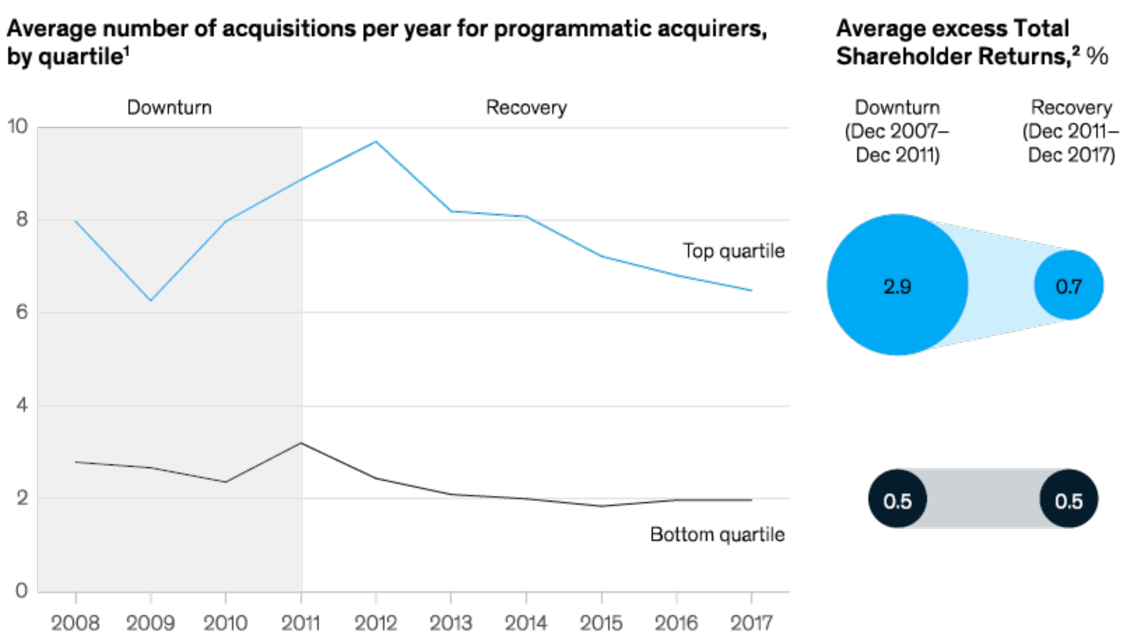
While recognizing the meaningful differences between today's COVID-19 crisis and the GFC, we see lessons from the GFC worth considering today. Analysis of the GFC has shown that companies can drive value creation through M&A during downturns by pursuing active M&A programs (Exhibit 1). Similarly, private equity funds that were more acquisitive during the GFC outperformed their less acquisitive peers.[2]

We evaluated Consumer Goods M&A activity from 2013-2018 in "The next wave of consumer M&A: executing for value," which took an "archetype" view of deal activity during that five year period.[3] We identified the three most common consumer goods deal archetypes, based on a review of 1,040 acquisitions completed by 119 companies between 2013 and 2018 (Exhibit 2). Our analysis found that companies focused on "snapping up challengers" achieved the highest median TSR (6.3 percent), while companies that "bet on adjacencies" had the lowest (0.4 percent), and companies that sought to "expand the portfolio" landed in the middle

[1] "COVID-19: Implications for business," updated July 2020, McKinsey.com.
[2] Preqin Fund Data.
[3] Anish Ksohy, Rocky Lipsky, Stefan Rickert, Rodrigo Slelatt, and Kristi Weaver, "The next wave of consumer M&A: Executing for value," October 2019, McKinsey.com.

Exhibit 1

In the last downturn, the most active programmatic M&A acquirers outperformed their less active programmatic peers by about 6x.



[1]Based on deal volume.
[2]Calculated as the average excess total return to shareholders for each quartile.
Source: CPA, Deal Patterns 2017, Thomson Reuters

All consumer sectors will feel the economic impact of COVID-19.

(3.3 percent). This was particularly true for those companies that took a programmatic approachto challenger acquisitions (that is, companies that did ≥1–2 small to medium deals per year and primarily participated in "challenger deal" archetypes). Their corporate performance exceeded the industry substantially with 8.3 percent TSR.

Several trends that emerged during the GFC (such as shifting to value brands and channels) and after it (such as the explosion of small and challenger brands) influenced consumer-goods companies' strategies for the future. Similarly, we believe COVID-19's impact on consumer sector trends, seen in our recent article, "How consumer-goods companies can prepare for the next normal," will help inform how these M&A archetypes will evolve.[4]

Impact of COVID-19 on consumer sector trends and implications for Consumer Goods M&A

COVID-19 has accelerated existing trends and created new realities that will affect the frequency of M&A activity and the types of deals in the sector.

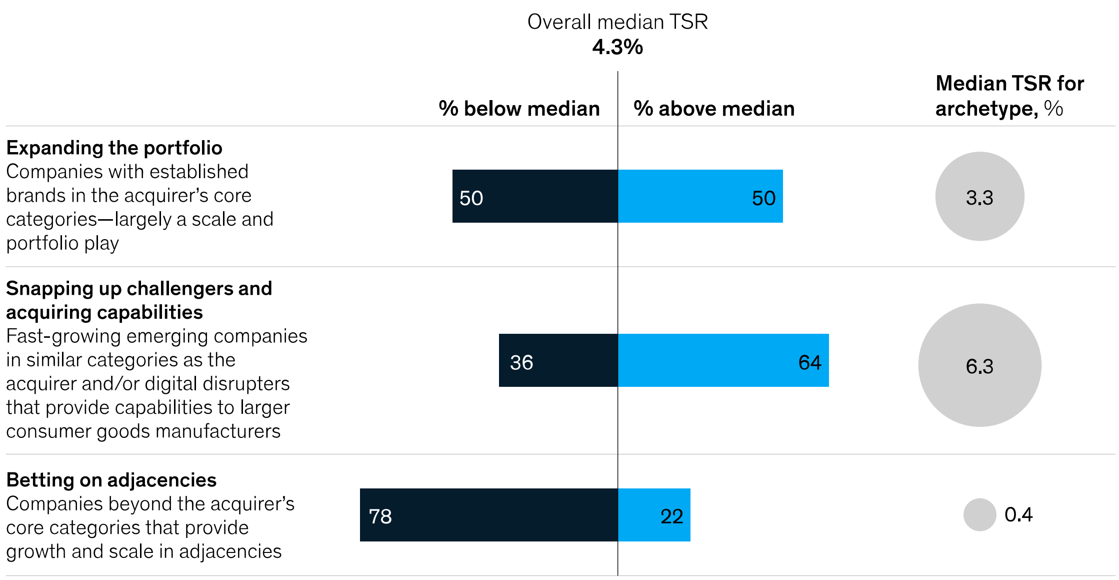
Heightened consumer awareness of health and wellness is reinforcing the trend toward healthier

[4] Raphael Buck, Tracy Francis, Eldon Little, Jessica Moulton, and Samantha Phillips, "How consumer-goods companies can prepare for the next normal," April 2020, McKinsey.com.

Exhibit 2

There are three deal archetypes.

Distribution of total shareholder returns (TSR) for consumer goods companies, by archetype, % (n = 119)



foods and lifestyles. This should continue to pique interest in assets in this space and may accelerate large manufacturers' interest in smaller, more "natural" food brands across categories.

The financial uncertainty associated with an economic downturn is increasing consumer focus on value, leading some consumers to switch to private-label or value-oriented products. As companies look to protect category market share, they may consider acquiring value brands that help insulate them from a shift to private label.

This time of crisis has also led consumers to return to big brands they know and trust. While large consumer goods manufacturers represented ~50% of sales in 2018, they accounted for only 16 percent of growth in 2015–2018, that share of growth rose to 39 percent in 2018–2019 and reached 55 percent in the first three weeks of April 2020.[5]

This new strength will support large traditional manufacturers' pursuit of smaller brands that may not enjoy such tailwinds as a result of the crisis. Larger manufacturers may reassess their strategy for slower-growing heritage brands. They may take the opportunity to divest noncore heritage brands at more attractive valuations or allocate investment to foster innovation and growth of their heritage brands.

COVID-19's demand shocks have increased the importance of supply chain resilience as retailers actively manage product availability. This challenge has laid bare the shortcomings of smaller producers that depend heavily on co-manufacturing. Large producers may look to purchase smaller challenger brands at lower valuations and/or shore up supply control though additional vertical integration.

Increased e-commerce penetration and in-home consumption likely will increase interest in digital and last-mile delivery capabilities across large manufacturers, leading large producers to participate in emerging ecosystems and seek acquisitions in data and analytics or last-mile delivery.

Evolution of Consumer Goods M&A deal archetypes postcrisis

As companies continue to navigate the crisis in the coming months, their focus on the health of employees, customers, and consumers and on financial resilience will remain paramount. After addressing these core issues, their focus will shift to emerging from the crisis stronger and to reimagining their businesses. We expect today's trends to encourage companies to undertake a holistic evaluation of their strategic ambitions, business models, categories, and brands.

As part of this re-evaluation, some companies will identify a role for M&A in their portfolios, which may mean acquisitions to pursue inorganic growth or divestitures to fuel growth elsewhere. M&A decisions, as always, will be company-specific, as a deal that's right for one company (for example, buying a challenger brand at a potentially lower multiple than last year) may not be the right deal for another. Financial stability, multiyear strategic direction, product and brand portfolios, and pre-crisis positions will all be important factors for companies to consider. The key for companies will be to take the time required to think about M&A strategy before rushing into deals. Finding the right asset is preferable to getting the wrong one at a lower cost than usual.

For consumer goods companies for which M&A can jump-start a new journey or course-correct a current one, we see multiple possibilities for each of the deal archetypes to propel growth—as well as the need in some cases for divestitures.

Expanding the portfolio. First and foremost, scale will matter again. Across categories, retailers will have more confidence in the supply chains of larger manufacturers; big brands are again winning consumers' trust; and products from scaled consumer goods companies will be more readily available. While driven in part by COVID-19, the re-emergence of household brand names and growth in large manufacturers' portfolios were already happening before the crisis.[6]

[5] Nielsen, nielsen.com. (52 weeks ending June 16, 2019) – (52 weeks, ending June 20, 2015); (52 weeks, ending June 15, 2019) – (52 weeks, ending June 16, 2018); seven weeks ending April 18, 2020.
[6] Nielsen, nielsen.com. (52 weeks ending June 16, 2019) – (52 weeks, ending June 20, 2015); (52 weeks, ending June 15, 2019) – (52 weeks, ending June 16, 2018); seven weeks ending April 18, 2020.

While scale is coming back, it has changed. New types of scale in the form of data, platforms, and advanced analytics capabilities will provide a competitive edge in the future. As companies look to secure such scale, they will need to consider a wider range of partnerships.

With the right timing, companies with healthy balance sheets and debt ratios will find opportunities to acquire long-desired assets at a discount. Furthermore, deals to expand the portfolio are the clearest winners in reducing per-unit costs across the portfolio. Company executives will need to look seriously at the value of increased resiliency and ask how long the window of opportunity to shape their portfolio, while realizing incremental value, will last. Recent shifts in market sentiment demonstrate how quickly opportunities can disappear.

Large manufacturers with some combination of relatively low leverage, access to investment-grade debt, and a cash-heavy balance sheet will be particularly well positioned to capitalize on this deal archetype. They will, however, likely need to navigate increased scrutiny from shareholders on the size of synergies that can be achieved.

Snapping up challengers and acquiring capabilities. We believe that consumer trends will encourage companies to use M&A to bolster their capabilities and build their next normal business model.

While growth is likely to be tempered for some challenger brands, the original premise that made them attractive to large consumer goods companies still holds—bringing larger companies new capabilities, loyal fan bases, and innovative products.

The crisis has highlighted the structural disadvantages that many challengers face. Heavily co-manufactured supply chains mean less control over shifting production in a crisis, and smaller balance sheets highlight the cash-flow issues associated with highly variable demand. Both can cause retailers to prefer larger brands with greater supply reliability. Furthermore, large manufacturers have invested heavily in digital capabilities to close some of the gaps with their smaller peers. These dynamics will likely depress the valuations for many challenger brands and provide an opportunity for larger companies to build capabilities through acquisitions and/or partnerships.

The challenger-related M&A activity that we expect to see will probably mix partnerships and acquisitions. Some deals in this archetype have proceeded through COVID-19 (for example, Nestle Purina's acquisition of Lily's Kitchen,[7] Puig's acquisition of Charlotte Tilbury[8]), and many of these smaller companies' attributes that attracted larger manufacturers in the first place remain—leading digital engagement capabilities and extremely loyal consumer bases (such as with Glossier) or e-commerce-related go-to-market advantages (such as with Pharmapacks). The shift to e-commerce, greater reliance on digital marketing, increased importance of ingredient transparency, decline in the food-service channel, and the critical role of last-mile delivery all suggest the need for stronger digital connectivity between consumers and manufacturers and emphasize the importance of e-commerce capabilities.

Consumer goods companies will have to answer several questions about building tomorrow's capabilities today. What downstream partnerships can you forge that will give you an advantage as e-commerce gains importance? What data, analytics, and digital marketing capabilities should you invest in and how? How can you boost your e-commerce capabilities quickly? What distribution or last-mile delivery investments should you make? What should you bring in-house to better prepare you to manage this new ecosystem?

Our past research indicates that a programmatic approach to snapping up challengers and building capabilities yields the best outcomes of the three deal archetypes. We believe that consumer goods companies at the forefront of acquiring and/or partnering with disrupters will likewise win down the line.

[7] "Nestle's Purina PetCare acquires natural pet-food brand Lily's Kitchen," Nestle, April 1, 2020, nestle.com.
[8] Aaron Kirchfeld and Dinesh Nair, "Spain Perfume firm buys makeup brand Charlotte Tilbury," Bloomberg, June 4, 2020, bloomberg.com.

While scale is coming back, it has changed. New types of scale in the form of data, platforms, and advanced analytics capabilities will provide a competitive edge in the future.

Betting on adjacencies. This is the hardest archetype for consistently extracting value, as these deals generate the lowest median TSR. Postcrisis, we expect most companies to hunker down and focus on their core business. However, it is helpful to distinguish between horizontal adjacencies (that is, primarily diversifying into altogether different businesses or categories) and vertical adjacencies (that is, making acquisitions up or down the value chain).

Companies with the means and intent to pursue a portfolio diversification strategy will find the opportunity less expensive in a time of depressed but varied valuations. The impact of COVID-19 and the lack of resiliency it has exposed in some consumer sectors may increase the need for diversification. In addition, the divergence in valuations across sub-sectors may make equity financing of some adjacent deals more attractive.

Consumer goods companies with heavily co-manufactured supply chains may look to increase long-term resiliency by integrating upstream with critical suppliers. The crisis is highlighting the value of direct control, and some reduction in efficiency may prove an acceptable trade-off. Owning these assets may also support longer-term strategies to satisfy consumer preferences like sustainability. Some suppliers may require a cash infusion or outright purchase to survive.

The downstream disruptions caused by COVID-19 and shifts in channel consumption habits will require consumer goods companies to think more broadly about how they engage their downstream partners. Partnerships with traditional retailers, food-service companies, distributors, and online delivery platforms (including logistics) likely will need to evolve in line with long-term industry trends.

As companies look forward to the next normal and reassess the role of M&A in their postcrisis corporate strategies, several questions can help them rethink their M&A strategies (Exhibit 3).

Private equity. As PE players shift from managing their current portfolios in the crisis to looking for investments, we expect the role of PE funds in Consumer Goods M&A to evolve.[9] The current climate of uncertainty, state of the leveraged loan markets, and more limited ability to realize synergies (unless executing a buy-and-build approach) are likely to make would-be financial investors approach valuations cautiously.

[9] Alejandro Beltran de Miguel, Jeremiah Connolly, Alexander Edlich, Ari Oxman, Vivek Pandit, Laurens Seghers, and Elizabeth Skovira, “Private equity and hte new reality of coronavirus,” March 2020, McKinsey.com.

Exhibit 3

Implications of COVID-19 for deal archetypes going forward

	Implications of COVID-19	Questions to consider
Expanding the portfolio	Scale matters again ● Increased importance of resilient supply chains ● Consumer trust in big brands ● Breadth of product availability ● Long-term cost reduction	● What categories do I play in that would benefit from further scale? ● What categories and brands would be a source of strong growth? ● What dream deal may now be within reach? ● How will expanding my portfolio make me more resilient?
Snapping up challengers and acquiring capabilities	Challenger value proposition remains relevant ● Loyal fan bases and direct to consumer connectivity ● Innovative products, better-for-you appeal ● New capabilities "Challenger" acquisitions to "capability focused deals" ● Increased reliance on digital marketing due to shift online ● Greater importance of ingredient transparency ● Reduction in food service and the critical role of last-mile delivery	● What can I add to the brand that will help it survive and significantly grow in this environment? ● What downstream partnerships will give me an advantage as e-commerce becomes increasingly important? ● What data, analytics, and digital marketing capabilities should I be investing in and how? ● How can I quickly gain greater e-commerce capabilities? ● What investments should I make in last mile delivery?
Betting on adjacencies	● Previously "outpriced" adjacent industries, sectors, subsectors may now be more affordable ● Potential increase in upstream integration to ensure supply-chain resilience ● Increased importance of downstream partnerships to reach consumers in new ways	● Are there adjacent industries I've wanted to enter but haven't been able to in the past? ● How resilient is my supply chain? ● Are there any upstream parts of my value chain that I should consider vertically integrating? ● Are there any downstream or go-to-market partnerships I should establish? ● Can my balance sheet now afford a measured bet?

However, the global PE industry has an estimated $1.7 trillion in dry powder,[10] and some players have indicated that they see the current situation as an opportunity to invest in traditionally inaccessible companies and brands.[11] Furthermore, those who invested in consumer goods companies during the GFC saw slightly higher median exit multiples than in the prior or the following two years (Exhibit 4).

The financial impact of the COVID-19 crisis (for example, depressed multiples, scarcity of capital), coupled with the revival of large brands, provides the right conditions for PE investors to play a significant role in consumer goods deals, including in carve-outs of noncore assets, an area that has historically been of great interest to PE firms.

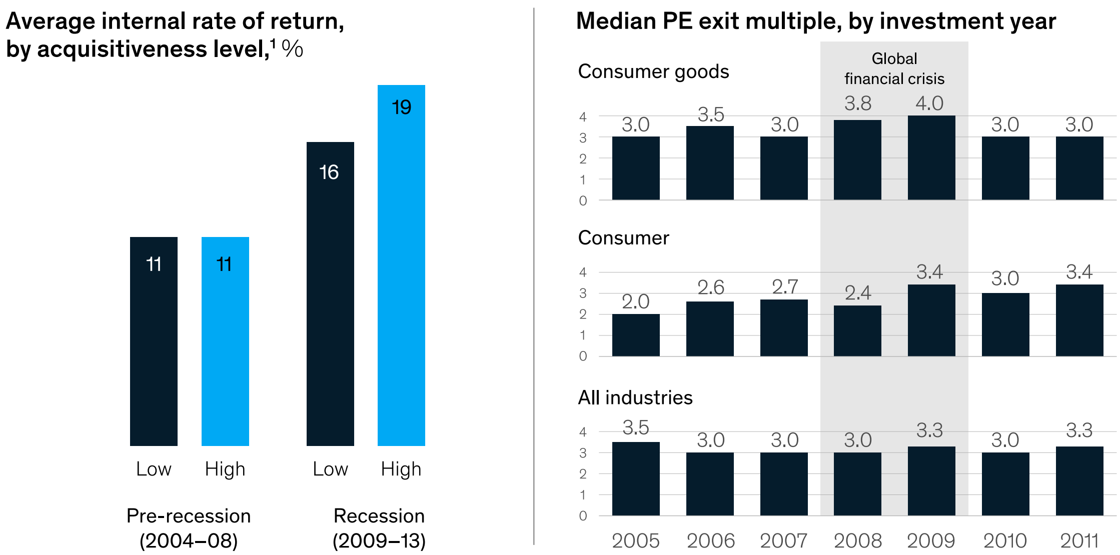
Divestitures. By and large, we expect most consumer goods companies to weather the crisis well. That said, some distressed companies will need cash to secure business continuity and strengthen their balance sheets, and many companies were already conducting strategic reviews of their portfolios before the crisis. COVID-19 provides fresh impetus for portfolio review, as companies will be able to compare how different brands performed in a unique period of demand fluctuation and see which brands did and did not benefit from increases in category demand.

Some otherwise well-performing companies will use this opportunity to carve out and sell underperforming businesses, or businesses that

[10] Preqin, May 13, 2020, preqin.com.
[11] K. Wiggins and M. Vandevelde, *Financial Times*, April 6, 2020, ft.com.

Exhibit 4

Private equity funds that kept investing during the global financial crisis outperformed, as did investments in consumer goods assets that were done in this period.



[1]Firm's acquisitiveness was measured by proxy as total deal value divided by total fund size. Firms were then classified by top vs bottom half on this measure. Performance returns are calculated based on the firm's acquisitiveness in the same time period—eg, 2009–2013 vintage returns are split based on whether the firm had low or high acquisitiveness during 2009–2013
Source: Preqin fund data

do not align with their portfolio strategies, to free up cash and invest in growth. As the recession loomed in 2008, the most resilient companies divested underperforming businesses faster than their peers and reduced debt by about one dollar for every dollar of capital on their balance sheets, while less resilient competitors added more than three dollars of debt.[12] TSR performance indicates that shareholders reward companies that take an activist mindset and use divestitures to dynamically manage their portfolio. Analysis from 2007–2017 indicates that companies that refreshed their revenue source by 10 to 30 percent outperformed those that did not on TSR by approximately four percentage points.[13]

Next steps for consumer goods companies

COVID-19 and the onset of an economic slowdown will likely reshape the landscape of consumer deals and partnerships in the sector. We encourage consumer goods companies to take three steps now as they contemplate M&A and partnerships going forward, all grounded in the three Cs of excellent M&A strategy—competitive advantage, capacity (financial and operational), and conviction.

Define the next normal—and where your competitive advantage lies. The first step in redefining M&A and partnership strategy is

[12] For more, see Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 2019, McKinsey.com.
[13] S&P Capital IQ, 2017; McKinsey analysis of 209 large listed companies.

M&A due diligence during the crisis

The crisis is consuming management attention (for both the acquirer and the target), leaving little management mindshare to engage in due diligence. In this climate, most diligence activities must proceed without any physical visits to facilities or the relationship-building, face-to-face meetings that often clinch or nix the deal.

These are unprecedented times, but we believe diligence can proceed despite the obstacles. Most diligence analyses happen remotely, and we see limited impact on them. To compensate for the lack of physical access, we have seen companies deploying creative solutions. For example, a single employee conducted a virtual site visit, live-streaming an in-person plant visit to a team of experts. We also see the business world getting more comfortable with virtual conferencing and 1:1 video calls to continue to make key decisions. While not a full replacement for physical meetings, these substitutes can work well in our current circumstances.

In addition to the typical diligence checks, two areas warrant heightened scrutiny:

Company health and liquidity

— Reviewing the pre-crisis growth profile and financials of the target and understanding how strong the company was then. Was the company already struggling, or was it doing well?

— Assessing the pre-crisis brand strength of the target and understanding the potential impact of COVID-19. Is this a strong brand that will benefit from increased consumer scrutiny?

— Evaluating the security and stability of the supply chain. Is the target a priority client of its suppliers, and will it be at the head of the line if capacity falls short?

— Assessing the financial position of the target (including cash) to understand the company's current situation and resilience in an extended period of disrupted economic activity. How long can the target withstand the crisis, and how long can you support the company if the crisis is prolonged?

Growth outlook

— Understanding the impact on the target of expected structural changes in consumer demand and behavior. Which changes are temporary and crisis-related; which are permanent?

— Given the structural changes, is the target well-positioned to thrive in the recovery and the next normal (from sales to operations)?

— What is the conservative base ("bankable") case? This is particularly important if COVID-19 has had a positive short-term impact.

understanding what the next normal means for your company. The new reality will depend largely on the lasting impact of COVID-19 on your core consumer segments, including their behaviors and spending habits. Where are the growth opportunities today, and where will they be tomorrow? Where are consumers spending money—in which categories and channels? How have their tastes, preferences, and concerns changed, creating new opportunities for differentiation? In this context, how have your competitive advantages changed, and what new advantages have emerged? How can M&A and partnerships accelerate your growth?

Assess your capacity to execute acquisitions and partnerships. A realistic assessment of balance sheet strength and your ability to make acquisitions independently, as well as your ability to secure financing in the postcrisis environment, will provide the critical foundation for your M&A strategy. Assessing the willingness of existing shareholders to accept dilution for attractive equity deals will also play a key role. Determining feasible acquisition targets will lay the foundation for prioritizing exploratory actions.

Build conviction with early exploratory actions in the M&A market. Consumer goods companies should generate data-supported perspectives on market trajectory, next normal scenarios postcrisis, and the risks of further disruption. Short-listing top priorities and securing executive and Board commitment to M&A will accelerate decision-making as markets thaw and potential targets emerge.

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The SG&A imperative in times of crisis

A crisis presents unique challenges in making wise spending decisions. Zero-based principles can help leaders move SG&A investments where they should be—rather than where they have always been.

by Ankur Agrawal, Stefon Burns, Kyle Hawke, and Matt Jochim

This article first appeared on McKinsey.com in May 2020.

The humanitarian cost of COVID-19 continues to unfold across the globe, affecting lives and livelihoods. Organizations are reassessing almost every aspect of their operations, asking urgent questions about how to allocate and deploy limited resources amid extraordinary stresses.

As the crisis evolves, with uncertain timelines and an unclear path to recovery, leaders are responding on multiple fronts simultaneously—working to safeguard their employees and customers and to understand significant volatility in demand, supply, and cost.

To support their businesses in the short term—and, ultimately, enable a recovery in the long term—organizations will need greater operational and financial flexibility. That will mean looking for opportunities both to preserve cash now and to be ready to reinvest nimbly for the future.

This requirement is leading CFOs to rethink how they can manage their sales, general, and administrative (SG&A) activities to identify opportunities for realigning spending in a rapidly changing business environment. Within separate business functions, leaders are also balancing the immediate need for resources against the longer-term need to build and maintain capabilities critical for a recovery, all while ensuring that their spending aligns with their corporate purpose and their many responsibilities to employees, customers, and communities.

One business leader noted that the easy decisions, such as those relating to travel and events, have already been made (or taken out of businesses' hands completely). By contrast, the majority of spending choices involve harder trade-offs, requiring new levels of visibility, governance, and thoughtful discussion so that leaders can align on priorities in making some of the most consequential decisions they are likely to face.

Lessons from resilient leaders

In 2019, our colleagues demonstrated that resilient companies—those that most successfully weathered the 2008 downturn—moved faster to create balance-sheet flexibility than their peers, and then accelerated faster as economic conditions showed signs of recovery. They achieved three times the improvement in operating expenses as a percentage of revenue than their "nonresilient" peers, and did so substantially earlier, "saving their powder" and preserving capacity to invest in growth, while keeping SG&A in line with sales as revenue fell. Additionally, most companies classified as resilient stand apart from peers on multiple financial and operational metrics through both downturns and recovery, including revenue and earnings before interest, taxes, depreciation, and amortization.

Building on experience from prior downturns, and recognizing the unique characteristics of this global crisis, we suggest a four-phase approach to help organizations respond to COVID-19-related shocks and the potential for prolonged economic uncertainty across the SG&A spend base. By utilizing some of the core principles of zero-based productivity, the approach enables increased spend visibility, enhances spend-management mechanisms, and improves the links between business strategy, financial forecasting, and frontline spending.

The four phases correlate to the stages we expect companies will follow as they find their paths to the "next normal" (Exhibit 1). In "resolve," companies manage an immediate reduction in spend. In building "resilience," organizations enable better spending choices by a deeper understanding of trade-offs. The "return" phase shapes longer-term reallocation and investment. Finally, "reimagine and reform" builds on new capabilities and knowledge to create a healthier long-term approach to SG&A.

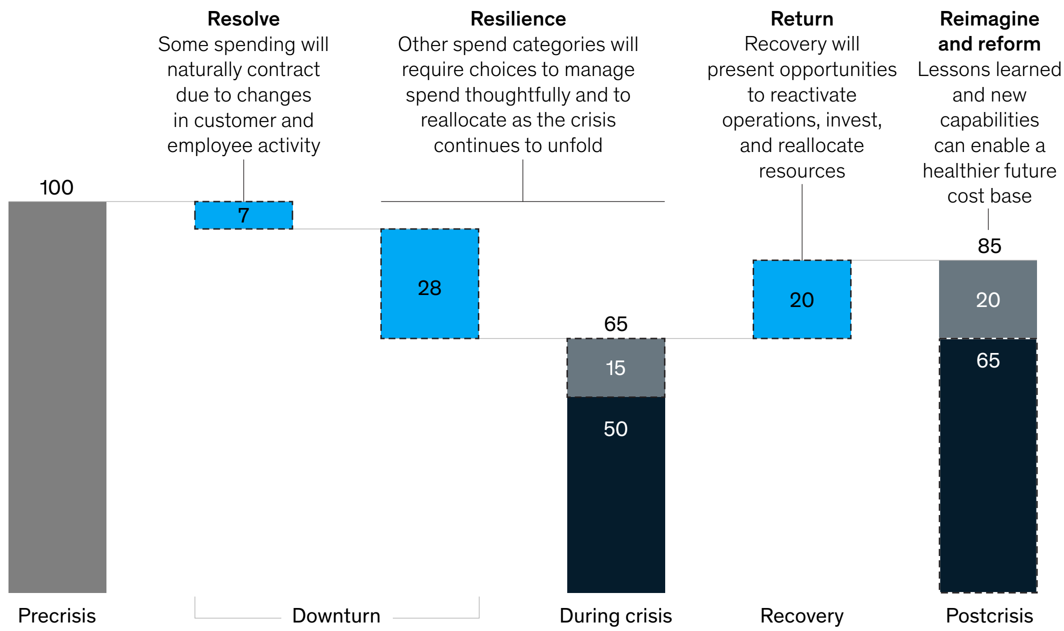
Resolve: Preserve savings

At this writing, many cities, states, and entire countries are currently under policies to shelter in place or stay at home, with varying levels of stringency. As a direct result, organizations are seeing an immediate reduction in some areas of spending due to lower activity levels from both employees and customers.

Exhibit 1

Reviewing all sales, general, and administrative investments helps leaders make conscious, strategic choices.

Sales, general, and administrative investments, illustrative, indexed to 100



Perhaps the most glaring example is travel spend, which has become effectively zero for many companies. Requirements for facilities maintenance and utilities are falling almost as quickly, as offices close and increasing numbers of people work remotely.

By taking quick steps to increase spend visibility, finance leaders can capture and preserve these savings—perhaps to fund immediate needs such as for new worker-safety measures—before they are absorbed elsewhere in the organization.

Resilience: Understand short-term spending trade-offs

A second set of spend categories within SG&A functions will also be affected by the crisis, but will not ebb on their own because the connections between the demand drivers and the resulting spend are not as straightforward. Instead, these categories will require a more involved set of choices about how to allocate resources—with a view not only to the immediate crisis but also to enabling longer-term changes as well.

In areas such as marketing, where return-on-investment (ROI) models often exist, a data-driven approach can inform decision making. For example, some campaigns, tactics, and brands that are no longer profitable will be easy to pause. Similarly, for products where volatile demand is outstripping available supply, uncommitted promotional spend can be curtailed. ROI-driven marketing models can also be used to reallocate investments across channels and geographies as consumer sentiment changes in specific markets.

Most large organizations are seeing major increases in demand for cloud computing, videoconferencing, and other remote-work technologies.

In the same fashion, investment in IT will likely need to be readjusted to free up resources in line with demand. Most large organizations are seeing major increases in demand for cloud computing, videoconferencing, and other remote-work technologies. Additional support may also be required for virtual selling channels as stores remain closed or salespeople are unable to meet with customers.

To sustain greater flexibility while making spending choices, organizations will likely need a mechanism for challenging spending requests—including those that are usually preapproved—based on a rigorous, ROI-focused process. These practices will reveal fast opportunities to implement shifts in strategy and policy as the crisis continues to unfold.

One organization recently launched a centralized spend-management team across its wide and distributed network of manufacturing sites. At each location, representatives from finance and procurement serve as spend challengers whose task is to question proposed allocations to make sure that each one has a thoughtful supporting ROI case. After remote training, the challengers now join daily videoconference sessions to review purchase requests across all indirect-spend categories. Purchase orders are approved, deferred, or denied based on rationale and criticality, freeing up resources almost immediately.

Through a similar process, organizations can challenge service levels across SG&A functions, embracing a zero-based approach by linking requests to essential requirements rather than the previous budget allocation.

Return: Make long-term resource-allocation choices in recovery

As the weeks and months progress, a recovery will ultimately appear on the horizon. Organizations will start to move beyond day-to-day crisis management, creating an opening to focus on decisions about how to reallocate resources to support recovery. One executive recently said, “Coming out of this, I want to put resources where they should be, rather than where they have always been.”

The strategic implications from longer-term application of zero-based approaches will naturally vary, but a few examples have repeatedly proved fruitful for businesses facing dramatic changes in their competitive situations.

— Shifting from fixed to variable-based arrangements with external service providers allows for increased flexibility and agility as revenue uncertainty continues. When revenue outlook becomes more certain, these shifts could be reserved, reverting to more dedicated structures.

- Rethinking the balance of dedicated external sales staff and inside sales teams to focus higher-cost resources on the higher-value interactions and potentially reduce cost.

- Reevaluating service models, such as by creating tiered service levels (gold, silver, bronze) for different parts of the business. The team responsible for contract management, for example, would automatically route requests from sales teams serving key accounts to the highest-level service team, while requests from sales teams serving smaller customers would be routed to a self-service option based on contract forms.

For example, one company—with a postcrisis reallocation in mind—has scaled its reskilling initiatives with a focus on known areas of future investment, expanding its curriculum for customer-service managers to cover new digital and analytics capabilities. This first wave of trainees will form a stable future pipeline of shared-service-center managers, who will be well equipped to lead the updated function as the business emerges from the crisis.

Reimagine and reform: Reset the approach to SG&A

With volatility already a rising concern for leaders over the past decade, the likelihood that reverberations will become part of the normal course of business seems high. Companies that realign their SG&A management can build in even more flexibility and resilience. This is a time to codify innovation into entirely new ways of working, based on robust, virtual working capabilities, strengthened collaboration tools, and expanded channels and modes of communication.

To sustain new ways of working, managers will need to develop and deploy talent more effectively, such as through targeted, accessible, on-demand capability building to help teams work better in a remote environment. Managers themselves will likely need new training to oversee centralized pools of employees, replacing the duplicative "shadow functions" structure in which business units staffed their own HR, IT, or legal teams, often in addition to headquarters functions. And for everyone, opportunities for up- and reskilling will aid retention and transition as redesigned processes enable people to focus less on repetitive, low-value-added tasks and more on valuable decision-focused skills.

The final move to consider is to align incentives and role-model new practices. At one organization, a finance director took on a "cost category leadership" role to demonstrate the behaviors expected from other leaders. While her role was focused on optimizing spend in the category she led, she talked regularly with individual team members, sharing best practices, communicating challenges to senior leadership, and celebrating achievements so that everyone in the organization could see that the way people worked was really changing—and that everyone from the top team down thought the changes were important and valuable. Other organizations add a new budget-transparency component to their core performance-management systems, so that new behaviors and mechanisms are maintained postrecovery and reset cultural norms.

Shift the operating model

To implement the new methods described above, three shifts in financial-planning and performance-management processes can help. These relate to spend visibility, budgeting, and resource reallocation (Exhibit 2). Across all three of these is one common theme: move SG&A investments where they should be—rather than where they have always been.

Improve spend visibility

Too often, corporate leaders have only limited understanding of what their organizations are really spending on. This is partially due to IT and financial-planning systems, and partially to a reluctance to share details by the people most directly responsible for costs—the cost-center owners.

Exhibit 2

Better financial planning, capital allocation, and ways of work enable important mindset shifts.

	Resolve truly variable expenses as demand falls	Drive **resilience** by making choices on where to adjust as the crisis unfolds	**Return** to normal by reactivating operations and reallocating dollars to where they should be, not where they have always been	**Reimagine and reform** investment levels and expectations coming out of the crisis
How	• Spending visibility • Spend linked to demand drivers • Policy changes	• Dialogue and debate on investments as scenarios unfold • Spend management based on return on investment (ROI)	• Quarterly plan with discretionary investment fund • Investments linked to ROI and approval process	• New ways of working (eg, improved effeciency, technology enablement) • Mindset and behavior change (change stories, role modeling)
When	Happening now	Likely throughout FY 2020	Scenario dependent, eg, Q4 2020	Scenario dependent, eg, FY 2021

Enablers

Spend visibility
Facilitate better dialogues on choices and trade-offs

Scenario-based planning
Set up a plan-ahead team

Intelligent zero basing
Link costs to drivers; force-rank discretionary investments to scale up or down easily

Dynamic resource allocation
Create a pool of funds for investment requests

But better visibility leads to better dialogues, choices, and trade-offs. The best type of visibility is always forward looking, so managers can make better decisions on spending before it occurs. Looking backward (for example, at budgeted amounts versus actual spending) is also helpful, as this visibility leads to a better understanding of any variances in budgets or plans. That helps cost-center owners develop action plans for future spending.

Achieving better visibility can be as simple as defining standard forecasting templates or tools, which are easy to aggregate and make comparisons across functions and geographies. The inherent uncertainty surrounding COVID-19 suggests that planning processes would ideally incorporate several forecasted scenarios. Nevertheless, with consistent application of the templates and tools across the scenarios, a simple set of key performance indicators can allow leaders to identify outliers, ask questions, and probe on granular investment decisions. This is in contrast to a black-box process, where forecasts are reviewed for SG&A in total at the business-unit level, and only compared to the prior year.

Move toward zero-based budgeting

The second enabling shift allows for budgets and forecasts that work from the bottom up to identify what is required to meet current internal and external demands, especially when those demands are frequently changing. This can take one of two forms: a driver-based plan or a zero-based plan.

Driver-based plans are helpful for indirect spend and transactional activities where a productivity rate can be defined. A driver-based plan takes three inputs—the volume demanded, a rate of productivity, and a price per unit—to calculate the budget automatically and adjust the plan as volume changes. For example, a telecommunications company used a driver-based plan to model how many outsourced call-center agents would be required as call volume increased and decreased. An automotive-distribution company is using a driver-based plan to flex their driver and fleet capacity as volume declines in the near term and comes back in the recovery. In both examples, the companies have effectively merged their financial and operational plans to eliminate duplicative work and keep the two plans in sync.

A zero-based plan is relevant for more strategic and discretionary activities. A zero-based plan means truly starting with a clean slate, with no reference point or other inputs, which forces the manager to define what they truly need. For example, an appliance manufacturer is using a zero-based budget to define, force-rank, and prioritize all outside services spend. This organization started by asking cost-center owners to plan all one-time projects from a cleansheet and do their own prioritization. This function-level prioritization was then aggregated for the executive team to review and decide how to allocate scarce financial and human resources. In this example, the executive team defined multiple thresholds that allowed them to pull back or further invest as market conditions evolved.

Dynamically reallocate resources

The final operating shift required is toward dynamic resource reallocation, which requires cost centers to plan in two steps: first, only for their bare minimum needs, and second—separately—for value-added investments and strategic initiatives. This simple change enables decisions to be made as business scenarios unfold, so that management teams can promptly defer, pause, or accelerate strategic initiatives. It is also powerful in unlocking the tight grip managers hold on their budgets, and identifying which spend is truly discretionary.

In the first step, managers identify what is required to "keep the lights on," using a simple but clear definition. For example, "If I don't spend this for two years, will we lose significant sales or market share?" In the second step, managers propose value-added activities, including both cost and benefits (financial or otherwise). These are aggregated and compared across the enterprise to make choices, and accept the implications.

Some companies choose to implement an "investment pool" approach. The executive team can make allocation decisions from a central pool of funds until they run out of good ideas or the fund is depleted. The first step is done annually to minimize work for the organization, and the second step is typically done on a quarterly (or even monthly) basis to fund new priorities as they come up throughout the fiscal year.

Other companies find a more workshop-driven approach to be helpful to create alignment. For example, the CEO of a European consumer-products company convened the leadership team for a series of full-day working sessions to discuss productivity proposals across businesses and functions, including the appropriate level of ambition, recommended changes, and implications across the business (such as for new processes, service levels, and ways of working). The team reached consensus on everything from harmonizing disparate management-report formats and changing the frequency and granularity of business-forecast updates to the role that HR business partners should play. The outcome was an aligned view of how the team would run the business going forward—and the productivity improvements they would be accountable for (collectively and individually) as a result.

These sorts of changes are best supported by a compelling change story that helps managers see how their actions support enterprise priorities when they might conflict with function-specific ones. At one industrial company, this was supported under the banner of "margin resiliency" and a series of communications to show how individual actions could allow the enterprise to emerge from the crisis stronger than they were coming in.

The current crisis has sharpened the imperative for CFOs to drive SG&A cost transparency and capital preservation. And while aftershocks and uncertainty will likely continue in the short term, organizations should remain vigilant and hopeful, identifying spending opportunities, making short- and long-term spending choices, and resetting their cost bases—guided by the operating-model foundations of better spend visibility, zero-based budgeting, and dynamic resource reallocation.

A crisis presents unique challenges complicated by uncertainty. Zero-based principles can help organizations thoughtfully align on what's important and put SG&A investments where they should be, rather than where they have always been.

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