Report

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05.2020
LONDON / GREAT BRITAIN

Envisaging the 'new normal'

THE POST-COVID-19 'NEW NORMAL'
BY SECTOR

Roland Berger

INTRODUCTION

There remains no doubt that the COVID-19 pandemic is progressively taking the global economy into turbulent waters. What's dire is the growing consensus that we are likely inching towards the most severe economic downturn since the Great Depression. The spread of the virus has already stunted business activity across different sectors. Some of this impact is temporary, driven by a shutdown of demand and supply, and therefore drying liquidity. Since the onset of the crisis we have been discussing issues, such as securing liquidity[1] and cutting costs,[2] to help companies navigate the crisis and prepare for a ramp-up. But given that part of the pandemic's impact is structural in nature, we believe a more fundamental change is imperative. A 'new normal' is inevitable.

This 'new normal' is influenced by several forces. Much of the ongoing commentary regarding the long-term impact of the pandemic has been centred on deglobalisation. This is understandable given the consistently growing popularity of nationalism across major world economies as well as the nature of the current pandemic fuelling anti-globalisation sentiment. Another topic that is being discussed widely is the change in consumer behaviour. While these two forces are important drivers of impending change, there are other pressing issues that call for comparable debates and analysis, such as the need for new regulations, innovative approaches to work, shifting dimensions of risk management, and the scrutiny of the social function of business. We expect seven key forces to shape the 'new normal'. Some of these forces are a direct consequence of the pandemic, therefore new. The others have already been in play and are gaining momentum due to the pandemic. While we try to paint a picture of the 'new normal', as we see it now, our objective is also to present a comprehensive framework to enable that visualisation.

Private equity investors who often invest across multiple sectors should reflect on this 'new normal' while planning the recovery of their portfolio companies and developing future investment strategies. These seven forces will have differing levels of impact on each sector, which in summary should inform decisions for private equity portfolios and future investments.

1 https://rb.digital/rapid-financial-assistance; 2 https://rb.digital/spend-compression

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1/ Forces shaping the 'new normal'

The economic crisis unfolding today due to the spread of COVID-19 is expected to fundamentally alter many aspects of the global economy. The number of ways in which this crisis can make structural changes to various economic sectors is far greater than what the global financial crisis did in 2008. We have identified seven forces that will shape the 'new normal' resulting from these structural changes. → A

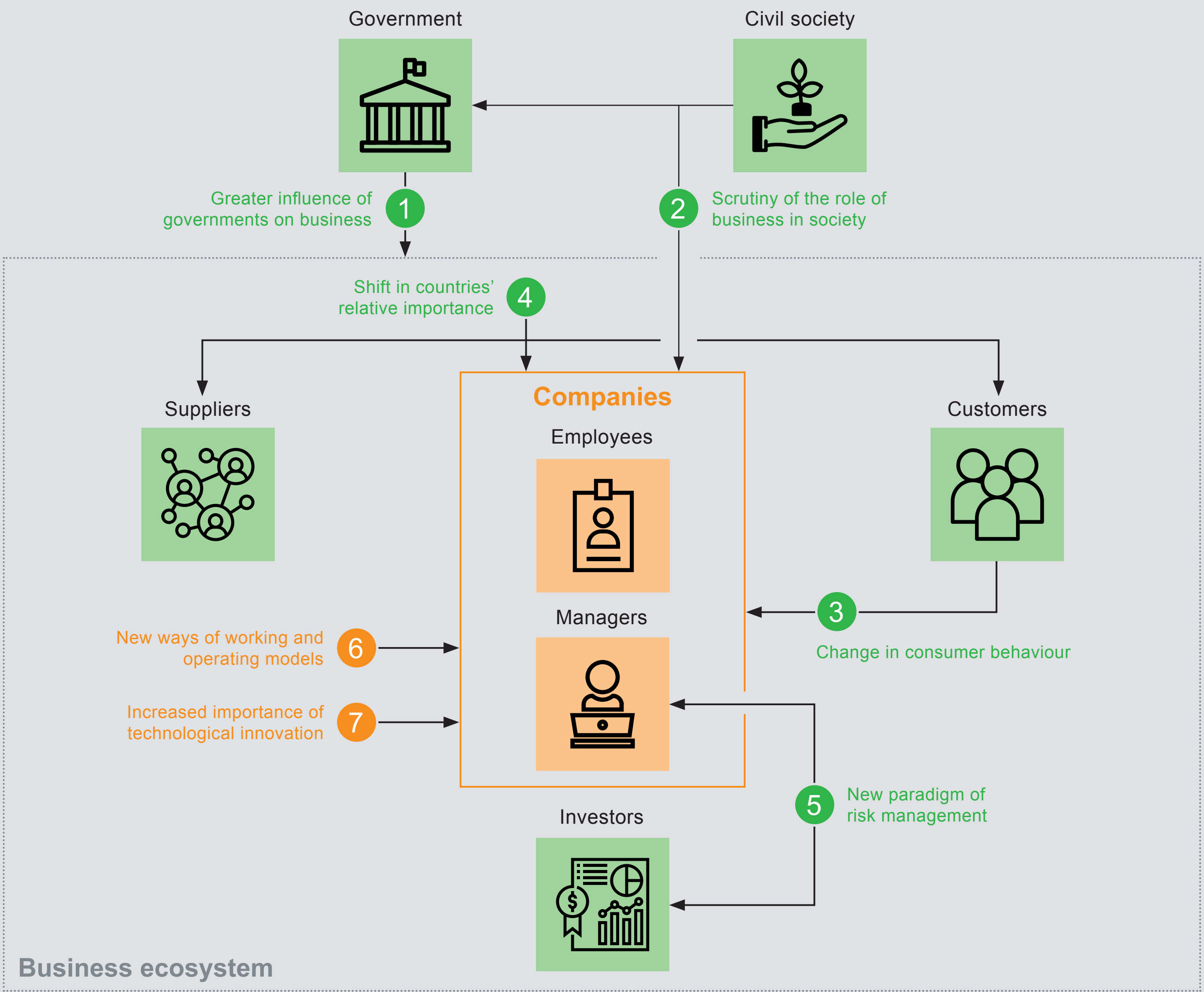
Together, the seven identified forces create a framework that can be used to comprehensively assess the impact of the pandemic on different sectors of the economy. These forces can be exogenous or endogenous to companies, and affect all the stakeholders of the business ecosystem. → B

A / Forces shaping the 'new normal'

1	**Greater influence of governments on business**	The pandemic has reinforced the centrality of governments' role in all aspects of society. Government-led social distancing measures, supply chain shutdowns, and economic interventions have all been instrumental in reining in the contagion so far. As governments move to further protect their economies and alleviate the odds of a second peak of the infection, some of their actions — such as new regulations, bailouts, and restrictions on dividends — would significantly affect businesses.
2	**Scrutiny of the role of business in society**	The pandemic has brought to the foreground the problems of income inequality, healthcare access and quality gaps, inadequate social safety net, and environmental degradation, among others. This is likely to impel civil society to intensify debates on issues such as universal healthcare, universal basic income, and climate change while scrutinising the role of business in ensuring public welfare.
3	**Change in consumer behaviour**	Prolonged lockdowns have altered and may continue to define consumer behaviour long after the viral threat subsides. What today may appear to be transitory conditions — such as lower and cautious mobility, higher propensity to shop online, greater dependence on digital services, heightened health consciousness, deeper environmental considerations, lower data privacy and protection concerns, etc. — could become the norm.
4	**Shift in countries' relative importance**	The closure of borders and disruption of production are testing the resilience of global supply chains and giving credence to the ongoing populist backlash against globalisation. The asymmetric impact of the virus on different countries may tip the current geopolitical balance, driven by changes in supply chain expanse, demand patterns, trade flows, and urbanisation.
5	**New paradigm of risk management**	COVID-19 has changed how companies and investors assess and manage risk. A pandemic has now moved from the list of 'unknown unknowns' to that of 'known unknowns' and has remodelled the categorisation of products and services into 'essential' and 'non-essential'.
6	**New ways of working and operating models**	Remote working during the lockdown has highlighted two contrasting trends: 1) the ability of the workforce to perform many business tasks effectively from home, at least for some sectors, and 2) the desire of the workforce to physically meet and interact with colleagues, at least for some time. This new binary opposition will enable organisations to rethink how they operate and strike an optimum between cutting their real estate costs and fostering collaborative, interactive on-premise work.
7	**Increased importance of technological innovation**	Given the magnitude of the crisis from a public health as well as an economic perspective, the importance of technological innovation as a solution to most problems has only increased. This would accelerate digital transformation, automation, and adoption of AI and machine learning across various sectors.

Source: Roland Berger

B / Impact of forces on key stakeholders



Exogenous forces

1. Governments can exert significant influence on all stakeholders in the business ecosystem
   - Incentives to customers
   - Loans to or investments in businesses
   - Trade restrictions on supply chains
   - Regulations for investors
2. Civil society's scrutiny affects companies' operations and influences government actions
3. Customer demand affects companies directly and their suppliers indirectly
4. Shift in countries' relative importance affect customer demand and companies' operations and their supply chains
5. New risk management frameworks influence how managers and investors assess and prepare for risk

Endogenous forces

6. New ways of working change the way companies operate
7. Technological innovation affects all aspects of companies' business

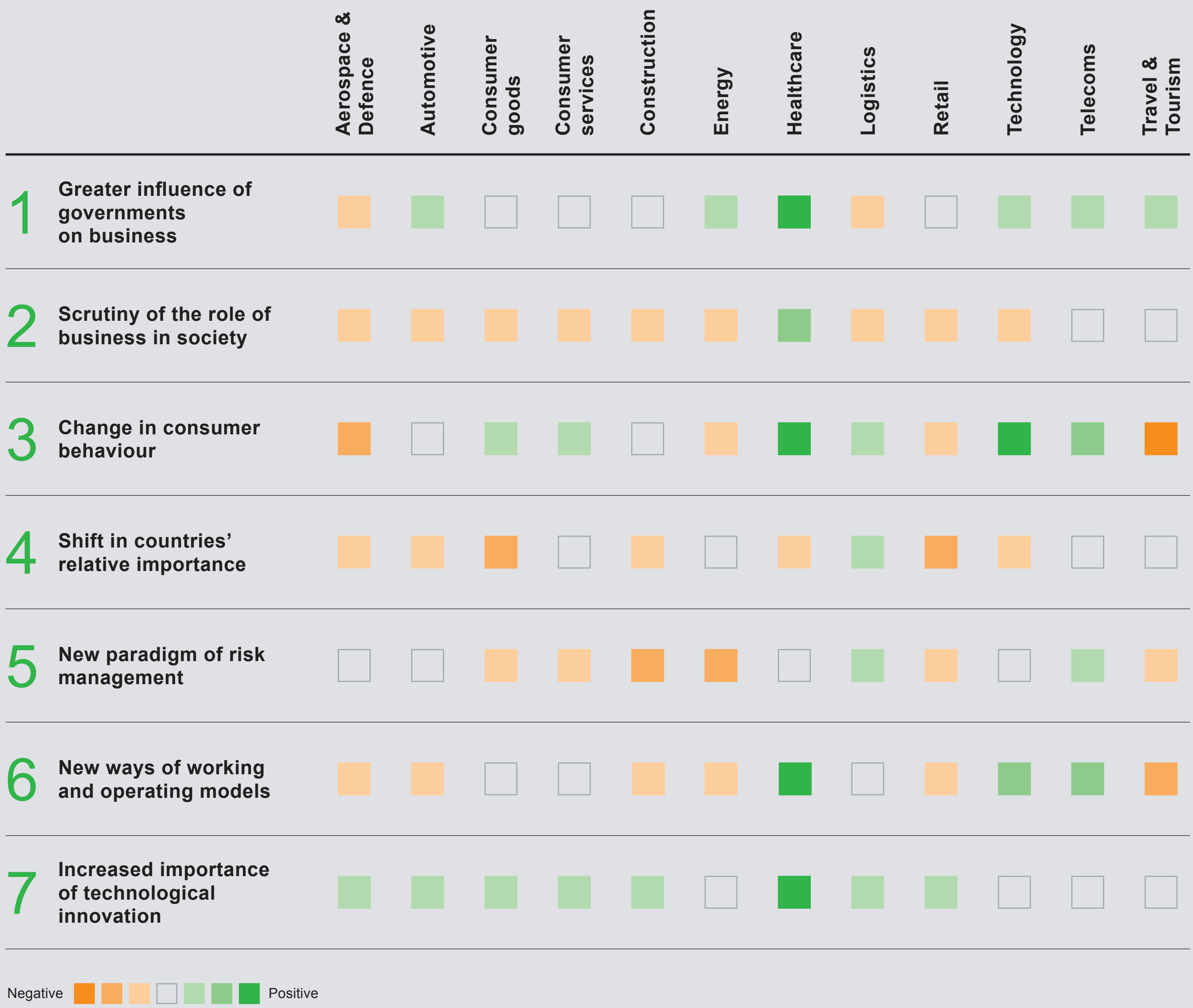
Internal shareholders   External shareholders

Source: Roland Berger

2/ Impact of the forces by sector

Compared with the pre-pandemic environment, the ‘new normal’ will look very different for certain sectors. Most sectors, except Healthcare, Telecom, and Technology, are expected to face a significantly dented ‘new normal’ in terms of demand, cost structure, liquidity, and uncertainty. Travel & Tourism and Aerospace & Defence appear to be the worst affected sectors, where a confluence of the seven forces is creating a challenging outlook for demand. → C

C / Forces shaping the ‘new normal’[1]

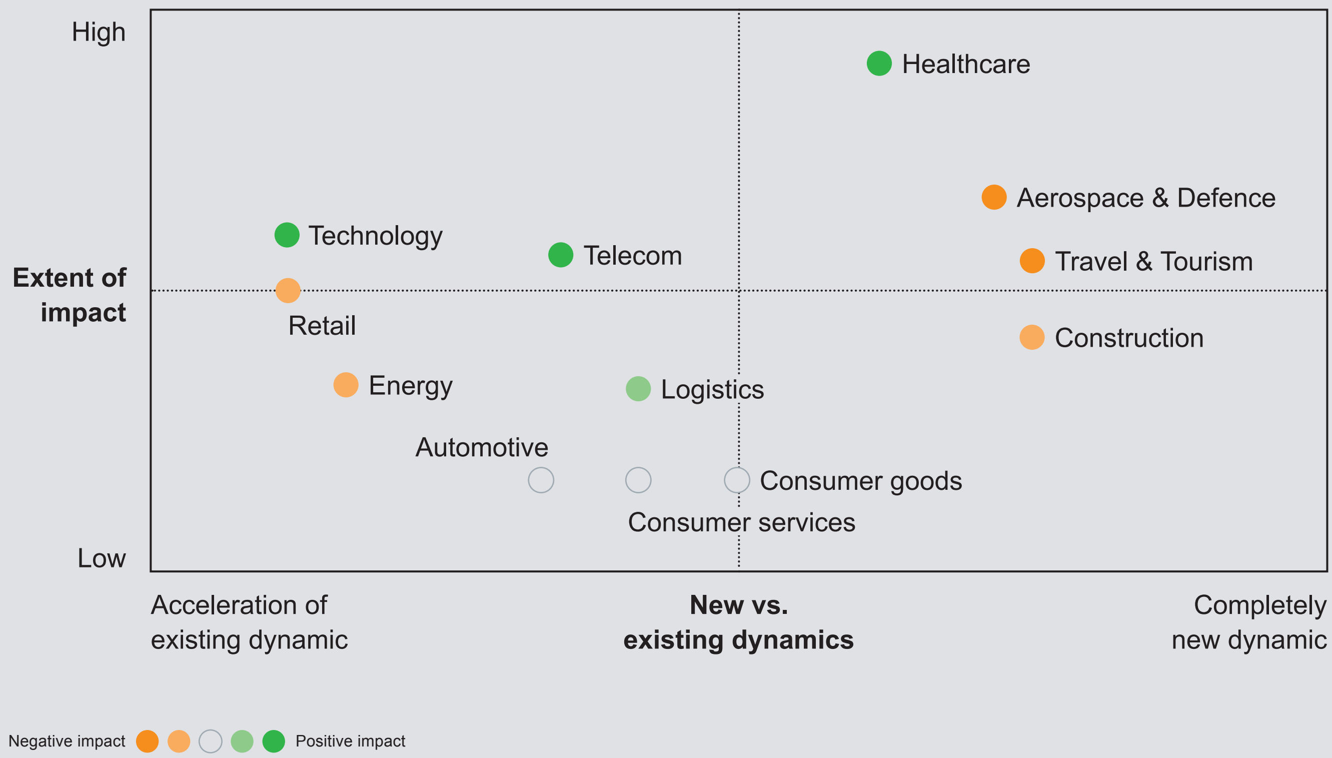


1 The authors can be contacted for a detailed impact analysis by sector.

Source: Roland Berger

Another approach to assessing the impact of the seven forces on different sectors is by differentiating between the new forces which are a direct consequence of the pandemic and those pre-existing which are likely to gain momentum. → D

D / Cross-sector comparison of the impact of the forces by type of force



Source: Roland Berger

AEROSPACE & DEFENCE

Change in consumer behaviour, in terms of their propensity to travel and the proven efficacy of remote working during the lockdown, may lead to lower demand for long-haul travel and new aircrafts. Defence manufacturing may also face lower demand due to reprioritisation of governments' budget away from defence to healthcare and social care. The resulting need to de-risk supply chains will come at a cost, thereby exacerbating the situation for the sector.

AUTOMOTIVE

A consumer base with lower propensity to commute and greater environmental consciousness could hurt demand levels, although a preference for cars over public transport could partially mitigate this impact. The need for supply chain resilience will likely increase costs. Automation and digitalisation can accelerate, benefiting the sector in the long term.

CONSUMER GOODS

The crisis reaffirmed the importance of the food and other 'essential' segments, which may see increased investor interest. Change in consumer preferences towards health can have an overall positive impact on the sector. Security of supply concerns may lead to reorganised supply chains despite increase in costs.

CONSUMER SERVICES

While accelerated adoption of e-commerce may offer new opportunities for digital players, physical service providers would increasingly need to consider omnichannel initiatives and/or strategic partnerships. Consumers would be particularly interested in services which complement their increased focus on health and flexibility. Employment protections for a reappraised 'gig economy' may increase business cost and threaten the business model of some players.

CONSTRUCTION

Change in demand patterns across end-markets would create opposing pressures on demand. Operational challenges may rise irrespective of the end-market. An increase in perceived risk may increase capital and insurance costs. Supply chain resilience would also come at a cost, while slowdown in urbanisation may drive up labour cost. However, accelerated digitally in this sector would present many investment opportunities.

ENERGY

The Energy sector may witness government involvement to save domestic companies and ensure energy security. Overall energy demand may suffer and transition to renewables would accelerate, driven by rising environmental concerns among consumers.

HEALTHCARE

The Healthcare sector is likely to emerge as the biggest winner. Higher healthcare spending per capita and increased investment in infrastructure is highly likely. The pressure to adopt universal healthcare may increase. A step change in remote healthcare adoption and digitalisation may accelerate these long-term trends. However, supply security issues may result in higher procurement costs.

LOGISTICS

Demand for warehousing and last-mile delivery may accelerate. At the same time however, logistics companies are likely to face challenges arising from higher employee cost, international trade disputes, and a reduction in passenger air travel which is essential for air cargo.

RETAIL

While e-tailers would ride a huge opportunity wave, the rapid adoption of e-commerce among consumers will create challenges for retailers with minimal to no digital presence. Omnichannel strategies, site closures, shop redesign, better use of technology in-store, and strategic partnerships may all be part of the transformation. Supply chain reorganisation and better employment protection will come at a cost.

TECHNOLOGY

Technological development may undergo a step change. Increased consumer preference for digital services, new remote working norms, growing acceptance of technology, and acceleration of automation and digitalisation across sectors will likely underpin growth in demand.

TELECOM

Categorisation as an 'essential' service for several functions which rely on connectivity will likely increase investor interest in the sector. New digital service areas, such as remote healthcare and distance learning, may further increase importance and long-term demand.

TRAVEL & TOURISM

Changes in consumer behaviour are likely to weigh heavily on the sector, particularly long-haul or international travel and tourism. Remote working trends would depress demand for business travel, leading to potential industry consolidation. Companies may find it hard to attract investors due to the secular nature of the impact.

Anticipating the fundamental change by sector at a juncture when the duration as well as the shape of recovery is highly uncertain is recognisably fraught with challenges. Availability of a treatment or a vaccine, for example, can quickly adjust or further modify the impact of some of the forces on the 'new normal' by sector.

Similarly, predicting the second-order impact of the identified seven forces is not straightforward. While trade restrictions and supply chain reorientation are likely outcomes of a shift in countries' relative importance, it is too early to forecast whether companies would move production to their home countries. The spread of the pandemic and governments' ability to control it and restart the economies quickly have been different for different countries. Some businesses may equate supply chain resilience to reducing their dependence on China. Others — given the efficacy of the Chinese government in containing the spread of COVID-19 and restarting the economy — could take an opposite stand. In any case, it is too early to jump to any conclusion. The aim of our assessment is therefore focussed on not only enabling cross-sector comparison but also providing a comprehensive framework to assess the long-term impact of the pandemic by sector.

3/ Implications for private equity

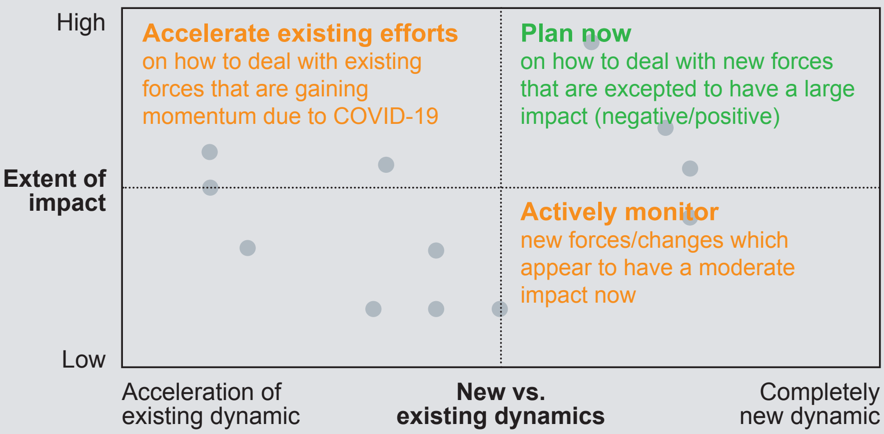
A crisis presents both challenges and opportunities. It creates winners and losers. And the crisis resulting from the COVID-19 pandemic is no exception. While on the one hand the pandemic has already brought some businesses to their knees and will create an unfavourable 'new normal' for some sectors, on the other it has come to provide the most innovative companies an opportunity to strengthen their competitive positioning and grow their market shares. The speed and efficacy with which owners and managers will prepare their organisations for the 'new normal' will determine their long-term success. Private equity investors should keep this in mind while working on their portfolio and scouting for new deals.

Private equity firms can prioritise their actions based on the dynamics of the force in play and the extent of its impact on the portfolio company. Proactively addressing the new and high-impact forces can help stay ahead of the curve in terms of understanding and preparing for the 'new normal'. → E

On the portfolio front, our cross-sector assessment can help private equity firms determine the extent of the impact based on their sector exposure. Since the start of the lockdown, private equity firms have been boosting cash reserves and cutting costs of their portfolio companies to secure survival. As they move towards recovery, ramp-up, and performance improvement, it is imperative to consider in their planning the 'new normal' for their portfolio companies. Uncertainty is likely to continue to define the impact of the forces, especially the second order impact. Active scenario planning can help address this uncertainty and prepare portfolio companies for their 'new normal'.

On the deals front, the same prioritisation can help. The most affected sectors will likely present attractive investment opportunities, for example, in terms of de-leveraging fundamentally strong companies. We should not forget that deals done during a crisis have delivered outsized returns.

E / Approach to prioritising efforts to address the 'new normal'



Source: Roland Berger

CLOSING REMARKS

> *The crisis resulting from the COVID-19 pandemic is going to structurally change the dynamics of all sectors in ways not seen even during the global financial crisis. We use the seven forces framework to envisage the 'new normal' at a sector level. Investors and business managers should extend this framework to the assessment of sub-sectors and individual companies. Active scenario planning can help address the uncertainty around forecasts and prepare companies for their 'new normal'.*

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Publisher:
ROLAND BERGER LTD
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RB_REP_20_005_ENVISAGING_THE_NEW_NORMAL