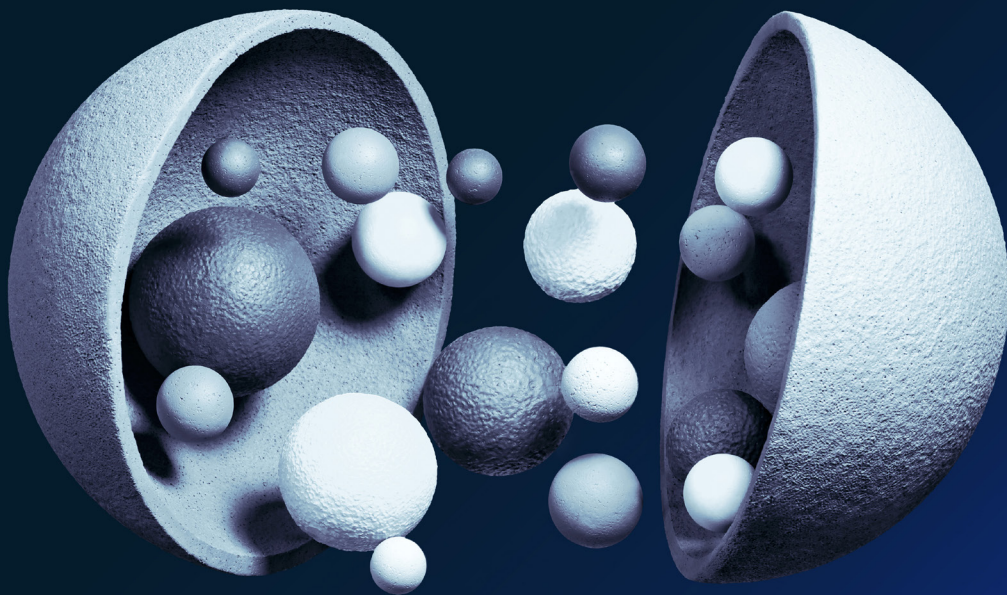


Risk Practice

COVID-19: Briefing note #91, February 9, 2022

The CEO job description just got a bit longer.



CEOs have always carried a heavy workload, but the issues they confront today add several fresh layers. Climate change requires a new way of looking at asset value that models the potential impact of various types of risk. COVID-19 and its aftermath means leaders must engage empathetically in topics relating to their employees' well-being. This week, McKinsey examined how the pandemic and other world events have added to leaders' list of most important tasks.

Climate change and the risks it imposes upon assets and markets is one of the biggest challenges confronting CEOs and other leaders today. The real-estate industry is already facing the need to build new capabilities that allow it to assess how climate-change risks alter values and what subsequent actions to take. Part of capability building involves understanding both physical risks and transition risks stemming from regulatory, social, and market reactions to climate change (exhibit). Once real estate and

Exhibit

Physical and transition risks have direct and indirect implications for revenue, operating and capital costs, and capitalization rate.

Implications of transition and physical risks, by direct and indirect effects				
	Transition risks Include changes in the economy, regulation, consumer behavior, technology, and other human responses to climate change		Physical risks Hazards caused by a changing climate, from floods, fires, and storms to rising sea levels and changing average temperatures	
	 Direct effect	 Indirect effect	 Direct effect	 Indirect effect
Revenue	Unattractiveness of a carbon-intensive asset to an occupier that has made a climate commitment	Decline in a sector or local economy resulting in lower local real-estate demand/occupancy	Disruptions to an asset's operations from severe or repeated physical-hazard events (eg, major floods)	Reduced real-estate demand in a local market given disruptions to surrounding transportation or other infrastructure
Operating costs	Increased utility costs given carbon-intensive building systems	Carbon charges on an asset given local regulations	Increased maintenance costs as physical risks increase	Increased insurance costs as insurers recognize physical risks and adjust underwriting models
Capital costs	Significant capital investment required to meet local energy efficiency/emissions standards or tenant demands (eg, early retrofit of heating/cooling systems), increased need to purchase lower-emissions building materials (eg, steel, cement, timber)	Increased financing costs as investors and lenders price in market-level transition risks (eg, in economies dependent upon carbon-intensive industries)	Investment required to improve the resilience of building to increasing physical risks (eg, elevating lobby, green roofs, protecting electric and mechanical systems)	Increased capital investments (eg, development fees) required to protect broader communities from climate risks (eg, floodwalls, green infrastructure for heat mitigation)
Capitalization rate	Changes in capitalization rate due to perceptions of both physical and transition risks by market participants			

other leaders understand value impact, they can proceed to decarbonizing and finding new sources of value throughout the climate transition.

COVID-19 brought on a new set of employee pressures, including trying to take care of work and children at a time when school doors close suddenly, and managing the 24/7 nature of working from home. These burdens also imply a new set of pressures for CEOs and other leaders as they attempt to support overburdened workforces. On the *McKinsey Talks Talent* podcast, McKinsey talent experts Bryan Hancock and Bill Schaninger discuss how leaders must engage in employees' lives and well-being in ways they seldom did in the past.

We're in one of the most bewildering labor markets in a generation, said Asutosh Padhi, McKinsey's managing partner for North America, in a CNN Business Perspectives commentary. CEOs can respond by expanding recruitment efforts to people who have work experience but don't have degrees; supporting more "gateway jobs," or stepping-stone positions that provide an income boost; and by challenging their organizations to embrace a more inclusive, skills-based approach to hiring and talent management.

Across industries, product-development functions are encountering a perfect storm of supply chain issues arising from the pandemic, the current labor mismatch, and evergreen themes of managing cost, quality, and time. Rather than becoming part of the much-bemoaned war for talent, companies can develop the capabilities of their existing workforce to fill skills gaps.

As the economy continues to reel from the effects of COVID-19, consumer-packaged-goods companies are under more pressure than ever. Prices for food and packaging commodities have increased by more than 22 percent. Manufacturing wages and labor costs rose in 2020 from 5 to 20 percent of total costs. To respond to these rapid, sweeping changes, companies need to transform their operating models to the new reality.

Given that economies are expected to shift away from stimulus spending and other policy supports, forecasters and economists generally project a slower pace for global growth in 2022—but one that is still faster than prepandemic levels. January's Global Economics Intelligence executive summary focuses on how inflation is playing out around the world, efforts to control it, and its impact on growth and employment.

Here are other key findings from our research this week:

- To better understand recent developments in sustainable packaging, we mapped regulations in 30 countries and found four common patterns. To ensure they comply with evolving requirements, packaging companies should track regulatory changes in their focus markets and implement processes to address future requirements proactively.
- Responding to a McKinsey survey, two out of three Americans told us their social values now shape their shopping choices, and 45 percent believe retailers should actively support Black-owned businesses and brands. Most retailers will need to make changes to meet the needs of these "inclusive consumers" by sourcing products that dovetail with consumer values and by communicating the changes to the public.
- Up to four-fifths of a product's lifetime emissions are determined by decisions made at the design stage. By building on proven cost-optimization techniques, companies can get those choices right.
- Myths often hold back heavy industries from activating agile working practices. However, agility in heavy-industry organizations can be used to make operational improvements, to enhance run activities, to augment all-important safety standards, and ultimately to become an enduring source of competitive advantage.

In this edition of Author Talks, Neil Hoyne, Google's chief measurement strategist, discusses

his new book *Converted: The Data-Driven Way to Win Customers' Hearts* (Penguin Random House, February 2022). *Data alone is not the answer for*

companies trying to grow, Hoyne says. Instead, companies can find growth by creating the right data strategy, leadership, and processes.

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