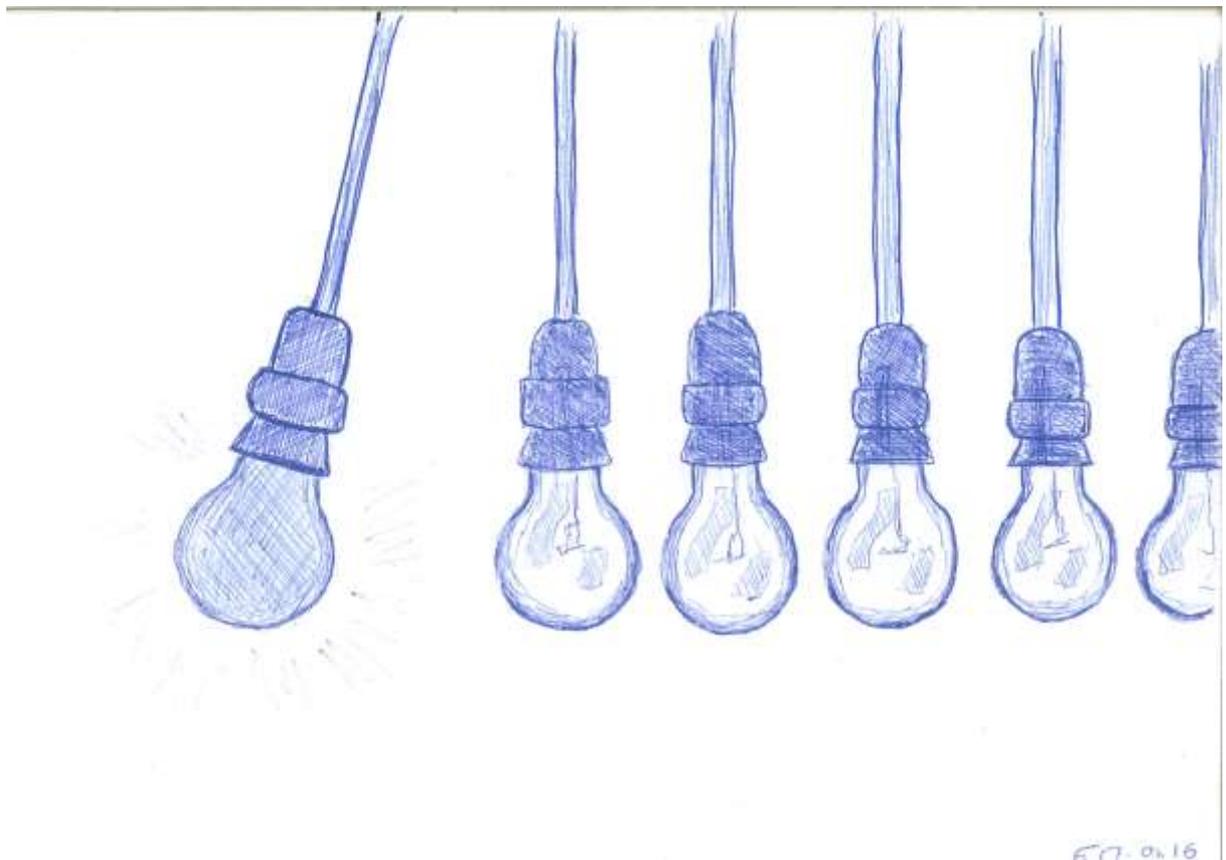


Supply Chain Disruption

There is one consequence of health crisis we have not talk much about. Nevertheless, it could change our way of consuming. Globalization and world-encompassing supply chains are once again under threat, this time from the coronavirus pandemic. The question we all have in mind: will covid-19 sink globalization?

“Change is inevitable, and the disruption it causes often brings both convenience and opportunity” Robert Scoble



“High time” (Grateful dead)

The death of globalization is announced by lots of experts. Although it has been mentioned several times, it is hard to imagine it might be happening. According to thought leaders after the 11th of September attacks, the SARS virus in 2002, the controversy in the 2000th over offshoring services, the GFC, BEPS and new OCDE actions, the trade wars between Trump and Xi Jinping, the global trade has been

damaged. People would like to be back to local consumption, back to nature, be more socially responsible, etc... All what is opposite to global trading. The populist trends are also another catalyst pleading for de-globalization. The expansion of supply chain may be decelerating or stopped in the coming months. I won't be surprised to see a "return to the local production" approach. It could be a lesson from this crisis. Health crisis could be the blow that eventually shatters them. On supply side, there were disruption of production, especially with China closed for a while. This outbreak pushed customers to consider other supply sources. The overdependency on suppliers has been underlined by many politics.

Supply plan "B"

Some companies have considered they were overexposed to shocks and that supply chain is critical. BCP's are necessary. Not only to have a second Chinese supplier but maybe a local one even if more expensive. It is part of a strategy more resilient and pushes to supplier diversification which is not financially the quest of efficiency has left companies without any plan "B" I am afraid. They were forced to re-think the global value chain. It also pushed towards more digitalization of the financial supply chain to reduce its length. And guess that in future, buyers will ask for BCP's to ensure their supply. An SLA is great providing the supplier can find and have ensured alternative solutions. A contractual indemnity would help but would not replace the total loss you could make. Capabilities, reliability, repeatability, and robustness of suppliers are elements, I am convinced they will now check in more details and with high scrutiny. Remember Fukushima. It wasn't that far, and electronic components chain was broken. Japanese have since then invested in finding external / outside the country supply solutions in case of. The reshoring of production can now be achieved with progress of technologies and robotics. Food manufacturers thought about modifying some recipes, if needed to adjust to supply gaps. The

diversification through a network may help large MNC's (e.g. Ferrero, Nestlé, Danone, ...). With ecological trends, onshoring of ingredients of recipes will also be put forward and become a sale argument/factor.

Swan song

It is one of the consequences of the COVID crisis not much has been said about. But it is fair to notice that the supply disruption may be the swan song of globalization as we knew it so far. People seem to discover the benefits from local supply. Supply chains build competitive advantage when local. It accelerates revenue growth in plant output, improve customer satisfaction, increase in inventory turnover, in savings with less transportation costs, lower operation expenses and increase cash-flows accuracy with advanced analytics and minimize risk and increase resilience in decreasing disruptions to the network. Therefore, there are numerous advantages to produce and supply more "locally". We also remember that Japan's Kumamoto earthquake in 2016 (for electronic manufacturer), US-China trade war for computer maker, and Thailand floods for automakers created major disruptions at the world level. We hope that trade finance will not dry up as always after crisis to fluidify the world trade of products some countries are missing, like medical equipment, drugs, food, etc.. The trade risk should not be pretext for banks to cut financing of supply chain. Especially since we have achieved major improvements in trade finance with new technologies.

There is always one cheaper than you

The outsourcing, basis of globalization (ask someone else to produce for you at cheaper price and get rid of what you do not want to make anymore) had positive and negative aspects. For example, in car manufacturing, they outsourced so much to smaller supplier in Germany that they now depend on the survival of these SME's which

sometime are able to produce one part which could break the whole production chain of a model. They went extremely far. For an electric car, supply of batteries has been stopped from China for a while. Here again, overdependency of foreign supply, not necessarily next door, and no alternative ways to keep producing.

Counterexample

Another interesting example, a bit contradictory, masks have been produced in millions in China when the situation improved there to supply France. But at the same time French produced local recyclable, cotton masks, cheaper and more ecological than classic FFP2 ones. Now the French factories are over stocked with masks. French believe a one-use surgical mask is better than cotton hand made. This counterexample proves it is not that simple to completely revamp the global supply chain.

Finding the culprit

Difficult to predict the future of globalization but one thing is for sure: businesses will be forced to rethink their global value chains. We should not scapegoat the “just-in-time” we have cherished for years. The MNC’s have thought for years in terms of just-in time where they should have considered the just-in-case. It remains the famous specialization dilemma. Some regions become specialists of a product, e.g. chips, and then we all suddenly depend on this region of the world, often in Asia. The dilemma is between partly onshoring and partly re-diversifying by outside supply (i.e. offshoring). It is paradoxical although true. It is why reality is much more complex. After COVID guess that some buyers will be ready to pay slightly more if you can guarantee supply in case of localized issue like in China end of year early 2020 with Corona virus. It has been a wake-up call for many MNC’s. We also saw that European solidarity was not always applied when it comes to pandemics. Do not forget

irrational behaviors like the toilet rolls and condoms. Fake news or rumors could generate supply issues and are extremely difficult to predict and anticipate. A supply issue pushes people to produce more of that missing product and then usually drives sooner or later to over-capacity because of over-estimate of the demand. It is tricky? We always learn from crisis and with COVID, there are no exception. Let us revamp our supply chain and let's not forget that "*The ignorant asserts, the expert doubts, the wise reflects*" (Aristote).

François Masquelier – ***Simply*TREASURY**.