Supply Chains strangled by the pandemic

Corona Crisis – and what next?

Very much like a super tanker in unknown waters, important parts of the global economy are currently being politically driven "by sight" – so, very slowly. But things will go on. Mostly politics is for "slowly and step by step", while the economy wants to make up for the lost time as quickly as possible.

by Daniel Janisch
Advisor Risk Management and Supply Chain
at glorisol.com Risk & BCM Solutions

For experts the global pandemic was not entirely unexpected. The WHO, the IMF, the WEF, individual national governments and civil protection organizations - all of them had repeatedly presented scenarios in the past few years that anticipated the current events - sometimes exactly as it came now. Were the conclusions of these scenarios incorrect? Were the countermeasures defined insufficiently? Or were the measures just not implemented timely and consistently enough? And why were some countries more successful in fighting the pandemic than others? Numerous Critical questions come from all possible directions. But the focus of this report shall be a different one:

The realistically predictable upcoming developments, consequential risks and interdependencies

Probably somewhere in southern China a virus began to spread in 2019 that months later triggered the COVID-19 pandemic - first in China, then with increasing speed throughout Asia and in the rest of the world. When the worldwide infection chains could no longer be limited by quarantines individually, lockdowns, curfews, contact restrictions and other limitations were imposed for containment.

When China began to ease its quarantines and curfews, the dependencies in global supply chains with the delayed restart of industrial production had already led to supply shortages in the rest of the world. This supply shock has a drastic impact not only on the economy. People’s lives are particularly affected by pandemic constraints, and what follows is a demand shock, which in contrary will require another round of adaptive adjustments to productions. Certain products will be in higher demand at times, while others will dwindle to shelf warmers. It is to be expected that these disturbance waves in changing intensities will continue to influence the economic situation for months, even long after the end of the pandemic-related restrictions. Under such circumstances, those who can react more flexibly to the market requirements in terms of time and products tend to have better chances.

The current situation

The current situation with increased border regimes, health controls and employee contact restrictions has led to significant backlogs within the global supply chains and at the consignees of ordered goods. Prioritization of public health and nutrition products has put practically every other production at a disadvantage. This has affected port delivery delays, closed border crossings and reduced cargo capacity on all logistics modes. It also emerged an increasing backlog of incoming and not forwarded containers, mainly in European and U.S. seaports. According to shipping company information, the resulting lack of empty container returns can lead to equipment bottlenecks for exports in China in some weeks and in turn hinder the supply chain there. According to employee statements at our main port-of-entry in Hamburg incoming full containers are currently “piling up to the pier edge”. Consequential interference waves must therefore be expected, even weeks and months after an end to the pandemic-related restrictions.

Governments and business associations expect that the second quarter of 2020 will be significantly impacted by the consumption-induced lower demand. However, that lull does not affect all industries and products. While large container shippers shut down their capacities (sometimes by 30% within a few days), air cargo companies are massively working overtime, as their capacities do not even begin to meet the needs due to global shortages of certain goods. Air freight prices went first through the roof, then through the clouds, and have multiplied to almost "stratospheric heights" within one month! That's also because lots of airfreight usually fly as a belly load on passenger aircraft, only <20% of which currently operate.

Paradigms and Risks

Production in low cost countries is worthwhile for larger quantities and with continuous replenishment via lowest cost transport modes. Small quantities and partial deliveries eliminate the advantage of production offshoring. Expensive air freight then may easily drive cost beyond the price levels common for high-wage countries. Now, the advantage is with those who can still produce small and medium quantities locally or buy them over short distances.

No one right now wants to think of supplier breakdowns and bankruptcies - also not with customers - but it is worthwhile to carefully observe the fast changing situation. The shock waves pose further risks: Even large container shipping companies could run into economic difficulties. As with Hanjin in 2017, not just capacities could suddenly be off the freight market, also the containers on the affected ships could become part of the bankruptcy estate. Or containers will simply not be unloaded once the shipping company can no longer pay the port fees or is no longer supplied with fuel.

Indicators and Time Lines

An important real-time indicator of the economic performance is the oil price. Despite the effects of the OPEC+ dispute, the slump is obvious: U.S. oil has fallen by 60% since New Year. Another real-time indicator is U.S. labor market data: Where Hire & Fire is more common, nominal fluctuations immediately pop up in the statistics. Never before there was new unemployment reported of +6M in one week or +16M in 3 weeks (previous record 1982: 650K). And production declines of more than the current -8% did not occur since 1946.

With a starting recovery, ocean freight prices are likely to remain raised for a while before returning to pre-crisis levels. Cargo capacities will come back in full later, because it takes only 4-8 weeks to effectively reduce the supply, while it will take several months before all the big rigs run as punctual as before. Airlines can reactivate their parked fleets very quickly if they keep their aircrafts and pilots certifications maintained. Air freight rates will go down once passenger flights start again. But even biggest optimists in that sector do not see stable logistics chains at pre-crisis level any earlier than Q4-2020.

Some new material and capital equipment orders are currently just being pushed-out, some are becoming more and more urgent, others may need to be readjusted according to new or additional criteria. This harbors not only risk to the market, but also big chances for flexible manufacturers that are open to changing customer needs. Indeed, there are losses due to the fact of items currently not being manufactured, not being sold or delivered late. Of course these losses cannot be nulled in full later because all the resources in terms of time and capacity of the production facilities are limited. And despite all workforce readiness, in particular human resilience limits the desirable catch-up to a certain extent. Until normalization is reached, companies have to ensure that fixed costs are offset by revenue or that reserves are used meaningfully.

So don't be too negative yet about the business year 2020. To win the future, there is a lot to be done now: On the one hand, maintaining close contact with customers and suppliers, secondly motivating employees during hard times and while doing that also making production more flexible in order to react quickly to market requirements and keeping an eye not only on own costs, but also observe the markets regarding some important factors:

- the ratio of inventory and sales
- corporate bond interest rates
- copper spot market prices
- the development of commercial loans
- sales figures for heavy trucks
- the personnel situation (short-time work / layoffs)
- bankruptcies, especially among SMEs and in retail
- and economical synchronicity

Outlook

The impact on the global economy will be severe. But it depends not only on the slump magnitude at the onset of the crisis, but particularly on how strong and how fast the recovery will be. News and reports, e.g., from the World Monetary Fund, currently take many different approaches and enormous uncertainties into account. But this also includes a catch-up hunt that could almost offset the 2020 decline with a plus in 2021. And that scenario very much goes along with the human inclination to move on and change things to the better. Still, due to the unprecedented circumstances, always expect surprises, good and bad - exploit the positive and fight the negative ones!

One does not have to predict the future in detail to foresee risk and that there will be again crisis situations and danger scenarios. The point is to react targeted and scalable with prepared multi-purpose plans in order to regain control of interrupted operating functions as structured and as soon as possible.

Now is the time to shape the future

Its up to you to use the current crisis experience - own as well as other one's - to make conclusions and plans to react on future crisis situations. And we are happy to professionally support you with that. Please also read below on the next page our updated, eaarlier article on ways of averting dangers in crisis situations.

Securing business continuity in times of crisis

Mastering Risks – Closing Gaps

Corona Crisis 2020 showed it very clearly: The identification of risks, the derivation of valid conclusions for danger prevention and the establishment of situationally scalable plans and feasible procedures for containing crises and combating emergencies is of utmost importance. But what is the situation in business?

by Daniel Janisch
Advisor Risk Management and Supply Chain
at glorisol.com Risk & BCM Solutions

Business people often talk about risk. The overall impression is that those involved know their current key risks well and strive to quickly counter them. Still, clear and tangible goals are set too rarely. And far too seldom the success of counter measures is monitored vs. the efforts. Same about interdependencies with the corporate strategy. It's the know-how in understanding risk factors and the structured, company-wide unified processing and prioritization what separates the hard fighters from the smart winners from the start. Sometimes organizations get lost in execution, or results can be inexplicable or even misleading if the terms, tools, and procedures for successful risk management are missing.

Organizations employ risk management for many reasons not only for due diligence or driven by legal requirements. Industry- or sector-specific regulations exist for the finance business, for airlines, medical device manufacturers, clinic operators, for new product engineering and many more. And since 2015, even the ubiquitous standard of Quality Management ISO 9001 requires the so-called «risk-based approach». Nevertheless, most of the requirements provide no help for the implementation of risk related methods, nor precise criteria or supporting guidelines for the assessment and further handling of risks. Mostly it's just very general requirements plus regular recurring review by experts. Adequate implementation is the sole responsibility of each individual business.

RISK

…is the «impact of uncertainties on organizational or corporate goals, activities and requirements».

- *Recognized risks are comparable by applying uniform evaluation standards across the entire company.*
- *Each individual risk is manifested by the extent of its impact and its probability of occurrence.*

Stress may arise when, for example, regulators, investors, key customers, or auditors raise questions about how the organization deals with its risks. Or when they exert pressure and demand justification. The advantage here is with those who base their work on generally applicable guidelines, e.g., the international standard ISO 31000, the COSO framework, or the ONR 49000 series, and who apply a generally recognized risk management process (framework conditions, identification, analysis, evaluation, coping, etc.; see figure 1). These standards can be applied to a wide variety of organizations, to all decision-making situations and are formulated generally enough for all types of business processes.

To ensure organizational viability, the risk management focus is on core functions. It must correlate with the strategic development objectives and target the risks related to these key goals. Day-to-day business, on the other hand, also harbors a wide variety of disruptions and irregularities. These could easily exhaust the risk management systems capacity and generate lots of nonsensical bureaucracy, but hardly give any benefit. For day-to-day business, continuous improvement is the instrument of choice for process performance optimization. However, as soon as an indicator can endanger viability by exceeding defined limits and it stands out from ordinary day-to-day business due to its unusualness or frequency, such input must be recognized by the risk management.

Sometimes incorporation of individual company functions in a comprehensive risk management is difficult, especially if finding synergies is preferred over isolated approaches. The most coherent of all possible solutions would be to place risk management as the integrating management tool above all other relevant sub-areas, such as ICS (internal control system), QM (quality management), CM (compliance management), SRM (supplier risk management), SSM (safety and security management) and BCM (Business Continuity Management), etc. Unfortunately, such a «Total Risk Management» often fails in reality due to conflicting objectives and technical or methodological requirements or due to priority expectations of individual sectors. Advanced organizations that strive for an "Integrated Management System" should, however, seriously consider elevating the risk management system the top level of their IMS.

Corporate risks are reasonably viewed from two directions: with a top-down approach along the company hierarchy from management to functional areas and a with a bottom-up approach along the process chain, starting with the lowest sub-steps. By this, no individual risk gets unnoticed and all go into coordinated processing. On a regular basis the top management level has to review that the risks processed in the risk management system include the ones that are strategically relevant for the entity. That is to enable the organization making better use of its opportunities during its further development by strongly reducing the impact of adverse factors.

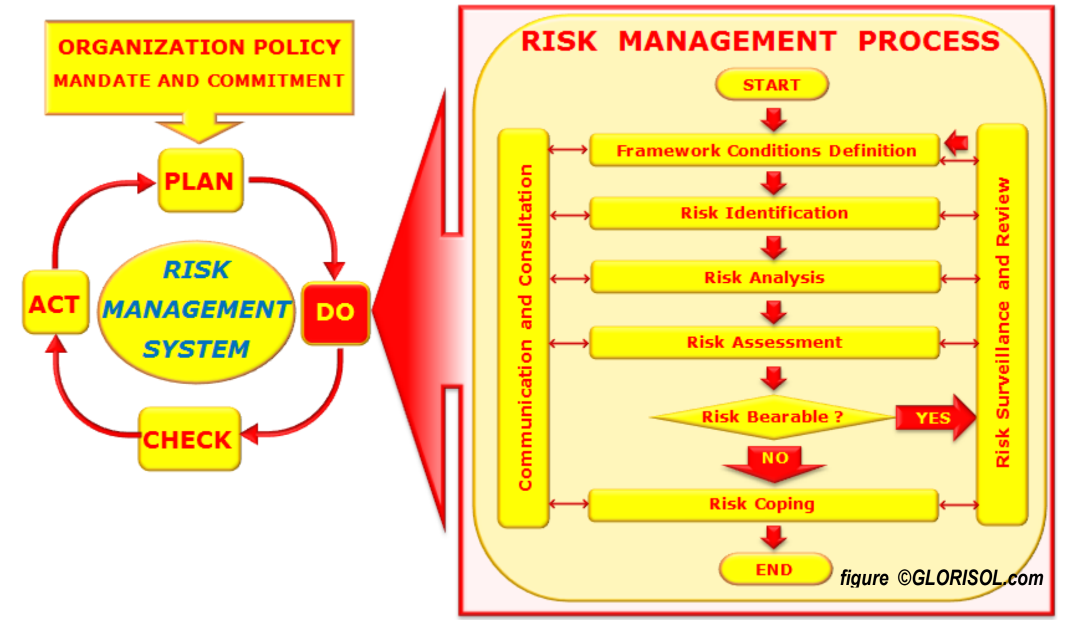

figure1: „from Risk Management Process to Risk Management System"

With emergency-, crisis- and continuity management as sub-segments of risk management, organizations can act more responsive to serious damages or events by utilizing prepared measures and regain control of interrupted operational functions in structured ways. For example by using a business impact analysis, particular operationally critical points in the organization are identified and direct relationships to the risk management process are established. Think about this: Your insurance can compensate for your damage - but your way back to normal you still have to find on your own. So why not develop multi-threat concepts as long as all your means are up?!

Companies that have successfully structured their risk management in meaningful ways thus have a useful tool for corporate management. They also gain more control over negative aspects' impact - so they have much more freedom to turn chances, competitive advantages and market momentum into profitability. That turns risk management to a factor of success and sustainable growth. Particularly in challenging times, e.g., in a large-scale pandemic situation, that may determine the difference between winners and losers in business.