

## HOW MANUFACTURERS CAN NAVIGATE THE NOVEL CORONAVIRUS' SUPPLY CHAIN IMPACTS

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The novel coronavirus (otherwise known as COVID-19) crisis has struck a serious blow to the manufacturing industry, which was already battling trade policy turbulence, a slowdown in global manufacturing growth and broader economic uncertainty. The virus' disruptive impacts are rippling throughout global manufacturing supply chains, particularly in the auto sector. Automakers rely heavily on China for auto parts, and some major automakers have temporarily closed plants in South Korea and Japan due to supply shortages, while others are racing to find alternative sources of supply in Europe or elsewhere. Not all parts can be easily sourced elsewhere, however, and some automakers may not have any other option but to wait out the crisis.

COVID-19 isn't the only issue plaguing supply chains. Even before the virus became a global crisis, manufacturers had to contend with the disruptive impacts of U.S. trade policy. According to BDO's Manufacturing CFO Outlook Survey, 21% of manufacturers say they've experienced a disruption to their supply chain as a result of government restrictions in the last 12 months.

We've summarized some of the crisis' specific impacts to manufacturers below:

- **Supply shortages and increased prices:** Until affected factories can resume production, manufacturers will need to rely on inventory stockpiles. However, these resources are limited and will run out eventually. When existing inventory runs dry, we can expect to see shortages and / or price increases throughout supply chains if alternate sources aren't secured.
- **Fulfilment delays:** Quarantines, travel restrictions, and workforce shortages can make it difficult or impossible for impacted manufacturers to fulfill their contractual obligations to their customers. A shortage or delay of products can seriously impact a company's reputation and may result in lost customers or even legal consequences.

- **Increased transportation prices:** Once factories can resume production, companies will likely rush to get their operations back online and make up for lost time, which could cause a sharp increase in transportation prices.
- **Economic impacts:** The COVID-19 crisis does not end when the outbreak is finally contained. How fast the economy—and the Chinese economy in particular—will be able to rebound from the crisis is yet to be seen, and any slowdown in global demand may exacerbate existing headwinds for U.S. manufacturing, which was already nearing a slump at the end of 2019. The Phase 1 U.S.-China deal provided some relief to manufacturers, but the coronavirus crisis could impede China's ability to fulfil its end of the trade agreement and delay any Phase 2 deal negotiations.
- **Reputational impacts:** A brand is a promise, and a company needs to consistently deliver on that promise to keep the brand strong. When a company fails to deliver on that promise—even if that failure is due to forces beyond the company's control—reputation can take a serious hit. The way manufacturers respond to COVID-19 delays or shortages will be an important dimension of longer-term brand preservation. Viewed with the right lens, manufacturers' response to the novel coronavirus is an opportunity for competitive differentiation. During times of crisis, demonstrated leadership, transparency and communication are highly valued and can earn customer loyalty.
  - The virus and last two years of trade turbulence have uncovered a prevalent problem in the manufacturing industry: a lack of geographic diversification in supply chains. The combined disruptive impacts of U.S.-China geopolitical tension and the coronavirus crisis have made it clear that manufacturers cannot be so dependent on one location for supply—namely, China.
  - To help get you started on protecting your supply chains against future unexpected crises, we've outlined six key considerations for supply chain planning that manufacturers should factor into their sourcing strategies.
- **Geographic diversification:** The coronavirus crisis is the latest proof that manufacturers need to revisit their sourcing strategies and consider reducing dependence on China or any one major location. Many manufacturers were already having these conversations as a result of the last two years of trade policy disruptions—according to BDO's Manufacturing CFO Outlook Survey, 36 percent of manufacturers have considered countries other than China for sourcing. By shifting supply sources to a variety of countries, companies can reduce the impact of natural disasters or government regulations on their businesses. When evaluating changes to supply chain operations, manufacturers will need to assess potential exit charges, permanent establishment status and the preservation of tax attributes on the movement of functions, assets and risks.
- **Increase visibility:** Technologies such as cargo-tracking, automated warehousing, cloud-based GPS and RFID introduce increased visibility into nearly every part of the supply chain. Surprise disruptions, which used to occur in supply chain blind spots—meaning areas where companies didn't even realize supplies traveled—are less common as a result. By capitalizing on these technologies and increasing their real-time visibility into every part of the supply chain, companies can more proactively identify areas of potential risk prior to an issue, or more quickly notice and respond to a disruption that does occur.
- **Sales and operations planning:** This crisis has changed demand in one way or another for nearly every manufacturer. Some have seen significant increases in demand for basic consumer goods, others have seen demand shift from various products or customer types, while others have seen demand fall with the uncertain economic environment. This is an important time for manufacturers to be agile in reacting to these changes and plan production, distribution, and inventory investments to optimize their reaction to these fast-moving challenges and opportunities.

- **Conduct a business continuity risk assessment:** Although companies cannot predict when a public health crisis or other natural disaster might occur, they can help mitigate the effects of unexpected disruptions by carrying out risk assessments. They may identify potential internal operational, financial and market risks, determine direct and indirect impacts, and generate contingency plans in case of unexpected disruptions.
- **Review your insurance coverage:** Manufacturers should familiarize themselves with their insurance policies so they are aware of the extent of their coverage. In the case of a public health crisis such as the coronavirus, companies should pay close attention to whether their insurance coverage contains a Communicable Disease Exclusion or not.
- **Engineer resilience and introduce agility for the future:** The best opportunity for lasting change is crisis. Once manufacturers have immediate mitigation measures in place, they should consider how they might reengineer their supply chain to be resilient by design, factoring in increased complexity and uncertainty as the new normal. In the months and years ahead, effective supply chain risk management will be all about agility and systems thinking. The supply chain itself must be viewed as an interconnected, interdependent network. Truly agile supply chains require end-to-end visibility across the entire supplier ecosystem, relying on real-time data to identify shifts in demand or disruptions faster and adapt to sudden changes faster. The agile supply network will eventually replace traditional lean approaches.

To learn more about how your organization can navigate immediate disruptions and prepare for the future, get in touch.

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