Supply Chain’s New World Order

COVID-19 and the acceleration of economic nationalism

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When events like the global COVID-19 pandemic completely—and rightly—dominate discussion in all spheres of life, distinctions between root causes and consequent effects easily blur. The coronavirus has forced many enterprises to pivot sharply as they contend with seismic supply chain disruption, and it has caught many of them flat-footed. To some degree, this is to be expected: the epidemic’s sudden and widespread impact falls under what former U.S. Defense Secretary Donald Rumsfeld might have called “unknown unknowns.”

But it has also cast an unforgiving light on how some companies have neglected to do the hard work of restructuring their supply chains for factors they could have anticipated. By analogy, while the specific outbreak of a new strain of coronavirus, spreading out from Wuhan, China, in December 2019¹ could not have been predicted, various national public-health authorities did warn of the possible spread of some kind of virus. The very different levels of national preparedness revealed by the spread of COVID-19 illustrates the role that pre-emptive planning and action play in managing disaster response.

These known knowns and known unknowns include a migration to economic nationalism that has gathered momentum during the past few years, and surfaced strongly again as nation-states respond unilaterally to COVID-19 developments. From an operations strategy perspective, economic nationalism is best characterized as a make-where-you-sell-and-buy-where-you make approach. Economic nationalism has in recent years shown up most dramatically in geopolitical events such as Brexit, a still unfolding U.S.-China trade relationship, and the renegotiation of the North American Free Trade Agreement.² Each of these events triggered both intended and unintended consequences, with the potential to dramatically influence the way supply chains are structured.

“The global COVID-19 pandemic has not caused the breakdown of existing supply chain paradigms. It has surfaced fault lines already in place for some time.”

—Brian Higgins, U.S. Practice Lead, KPMG Supply Chain & Operations

¹ Source: https://www.un.org/coronavirus
³ Source: Donald Rumsfeld, Known and Unknown (New York: Penguin, 2011), “Author’s Note”
How we got here: Internationalist pillars

Global supply chains for U.S. companies were largely designed at a different time, around four key internationalist paradigms. First, they mirror an accepted belief in the benefits of trade liberalization and global interdependency, as supported by rules-based institutions such as the World Trade Organization and European Economic Community. Second, they reflect long-standing labor-arbitrage and cost-of-doing-business differentials that encouraged the offshoring of selected operations and sourcing through lowest-cost third-party suppliers. Third, in the U.S., they leverage tax-code provisions that can often align to offer them advantage, such as exemptions for foreign-source income and offsets for taxes paid overseas. Fourth, they assume inventory buffering as a primary line of defense against supply risk, based upon historic consumption patterns and the ability to effectively manage long lead times. Important, all four pillars place a premium on stability and predictability.

All of these foundational mainstays/universal truths are now in some state of deconstruction, due to either geopolitical or market forces in evidence for some time. What has taken supply chain organizations by surprise is the pace of change and the new normal of sudden disruption. From a public policy perspective, for example, U.S. participation in the Trans-Pacific Partnership (TPP) first stalled and then effectively died with the stroke of a pen, after eight years of intricate negotiation between 12 countries. In markets, similar pacing and stylistic shifts hold true: Infinite customer choice, rapid shifts in consumer taste, expectations for instant delivery, and the proliferation of SKUs have all put a premium on supplier agility and made inventory-buffering strategies either obsolete or vulnerable.

“It’s certainly not lost on U.S. supply chain leaders that their current operating models reflect assumptions about international relations and trade practices that are increasingly out-of-date.”

—John Jullens, Principal KPMG Strategy

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4 Source: Colum Lynch, “Trump Takes Aim at Iran, China, and the Global System in Big U.N. Speech,” Foreign Policy, September 25, 2018

The end of “cosmetic surgery”

For some supply chain leadership teams, the path of least resistance will be to react and improvise as best they can, on a situation-by-situation basis. In our experience, such piecemeal contingency plans and relatively superficial management tactics will yield piecemeal results and a skin-deep business resilience. Identifying and qualifying primary and secondary suppliers, for example, with the belief that the business can shift volumes as conditions warrant, is one example of this kind of necessary-but-not-sufficient tactic. Risk management approaches based solely on process and procedure, but without the data and technology platform to effectively sense and monitor risks, is another.

Our experience suggests the supply chain organizations that will emerge strongest are those willing, by contrast, to see current emergency conditions as their opportunity to systemically overhaul their entire operating model. This is especially true given expectations for an unusually deep and long recession during the next 12–18 months. The post-COVID-19, end-state configuration, of course, will vary according to industry, company size, and supply chain maturity. At the same time, winners will share common approaches, behaviors, and competencies that have already proven themselves. (See sidebar.)

As a critical foundational matter, we expect the supply chain model of the future will deemphasize efficiency and lowest-cost as the dominant definer of value, in favor of a multidimensional value framework that assigns more equal weight to risk exposure, supply alternatives, tax considerations, and channel complexity. The metrics deployed to capture and manage these newer categories of value will have to shift as well. Tax considerations will play an increasingly important role in the design of supply chains of the future. Economic nationalism puts pressure on open markets and global free-trade. In its wake, we’ll find greater barriers to cross-border trade—increased tariffs, export controls, and trade sanctions. The past lent itself to designing supply chains without much worry of tax and trade barriers. Going forward, this approach could be quite costly. Cost-efficient and resilient supply chains will be architected with tax and trade as a significant design component. For example, although “build locally” may avoid import tariffs on finished goods, duties on imported components could be classified differently—giving rise to equally high duties, as well as withholding taxes on payments to group companies holding the rights to manufacturing patents. Navigating tax considerations will become a more nuanced and less prescriptive process that demands much closer partnering between Tax and Operations functions than has typically existed in the past.

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7 Source: KPMG, “The Road to Everywhere: The Future of Supply Chain” (October 2019)
"The global pandemic will add to the forces already eroding global free trade norms. In its wake, tax and trade will play a greater role in future supply chain design. This will necessitate a new level of collaboration between operations teams and the tax function."

— Brett Weaver
KPMG Value Chain Management Leader and International Tax Partner
A punctuated equilibrium: No going back

Though the full social, political, and financial impact of COVID-19 is not yet known, the compounded effects of recession, social disruption, and the secular trends we have discussed make return to the status quo increasingly unlikely. In our marketplace conversations, supply chain leaders share awareness that labor-cost differentials and fiscal incentives that drove off-shoring have been eroding for some time, and will continue to do so. They acknowledge that assumptions that the Chinese economy would embrace traditional western approaches to free movements of capital and goods have proven incorrect. They accept that customer demands for infinite choice, immediate availability, and instant delivery will continue to reshape markets.

In punctuating a supply-chain equilibrium already under stress, the epidemic has exposed an underlying structural fragility. We expect to see casualties, and not only among larger enterprises. Many leanly capitalized suppliers simply do not have the financial wherewithal to survive even a three-month shutdown, and the business viability of the survivors will be shaken. After COVID-19 recedes, additional and possibly different kinds of supply chain risk factors may emerge.

There is real work to do to get this right. COVID-19 has demonstrated that supply chain can be one the biggest sources of vulnerability for enterprises. News coverage of the epidemic has in fact driven the very words “supply chain” into general public awareness.

For specialists, conversely, it has shown that getting supply chain right is one of the biggest opportunities or value levers that businesses have, as they consider survival and sustained relevance in a world of new givens. We expect to see increased interest in strong enterprise COOs who can distill insight from a sea of data points, distinguish between leading indicators of significant long-term secular trends and high-profile outliers, and turn insight into action.

In our ongoing dialogue with forward-thinking supply chain organizations, leadership teams have consistently expressed interest in elevating the function to become a true strategic partner to the enterprise. Prior to COVID-19, they often described their ideal-state vision in terms of specific capabilities such as the deployment of predictive analytics to better strategic planning or partnership with suppliers to foster category innovation or strengthened partnership with critical back-office functions.

All of these priorities still matter, of course. The epidemic has raised the stakes, and added a new layer to the mix. Faced now with a new world order of extreme and possibly extended disruption, supply chain leaders are keen to ally themselves with the skills and insight—sourced inside or outside the enterprise—to anticipate and respond to known knowns, known unknowns, and unknown unknowns in ways relevant to their organizational objectives. They’re also digging in, aware there is substantial work to do. The new capabilities they seek are built, not bought, and take time, resources, and attention to bring into reality.
KPMG LLP is here to support you in this unprecedented situation. Organizations are asking mission-critical questions pertaining to supplier and operations risk that have arisen in the COVID-19 environment. We recognize that during this time, business leaders don’t only need solutions, but also reliable consultants.

Whatever your sector, more than 2,000 supply chain, strategy, and value chain management professionals from the KPMG network of member firms worldwide can help you address the issues of today from crisis response planning, to rapid diagnostic for supply and demand risks across your operation, to scenario analysis and contingency planning.

Our professionals are skilled in all areas of supply chain operations from strategy and analytics, to supply chain risk, planning and execution, and logistics and distribution. We also have the capabilities to help you integrate tax planning into your business operations to help minimize expenses and risk, enhance return on investment, and drive efficiencies across operations.

We are here to help.
Contact us

**Brian Higgins**  
Principal, Supply Chain & Operations Practice Lead  
KPMG in the U.S.  
T: 312-665-8363  
E: bhhiggins@kpmg.com

**John Jullens**  
Principal, Strategy  
KPMG in the U.S.  
T: 313-230-3000  
E: jjullens@kpmg.com

**Brett Weaver**  
KPMG Value Chain Leader and International Tax Partner  
T: 206-913-6697  
E: baweaver@kpmg.com

For more information, please visit us at:  
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