

Ep. 201 - Supply chain resilience

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# Call Participants

**ATTENDEES**

**Chris Rogers**

**Kristen Hallam**

**Unknown Attendee**

# Presentation

**Unknown Attendee**

You're listening to the Economics & Country Risk Podcast from S&P Global Market Intelligence. In each episode, our experts will provide you with the where, how, and when to make decisions that transform your business.

**Kristen Hallam**

S&P Global Market Intelligence sees five key overlapping themes for the year ahead. In this episode, we explore the theme of supply chain resilience. Supply chain resilience is vital and costly amid significant uncertainties related to labor and policy implementation.

Companies will weigh strategies such as inventory expansion, multi-sourcing, and reshoring. Will companies be willing and able to pay for necessary investments in these strategies as corporate cash flows come under pressure?

I'm Kristen Hallam, lead content strategist for Global Intelligence & Analytics at S&P Global Market Intelligence and your host for this episode of the Economics & Country Risk Podcast. Here to discuss supply chain resilience from S&P Global Market Intelligence is my colleague, our head of Supply Chain Research, Chris Rogers. Thank you for being here today, Chris, and welcome back to the podcast.

**Chris Rogers**

Well, thank you very much for having me back.

# Question and Answer

**Kristen Hallam**

Chris, in previous episodes, we've talked about the normalization of supply chains post-pandemic. If the trend is that supply chains are returning to normal, why invest in resilience?

**Chris Rogers**

Yes, I think it's a good question. Clearly, as a supply chain analyst, I'm going to want to make sure that people still pay attention to what we've got to talk about even if the world's not crazy. But the sad fact of the matter is you're never more than a few months away from some sort of significant supply chain disruption.

That might not necessarily be something as big as what we faced in the past three years, which was largely the result, as we've discussed in the podcast before, of consumer demand during the pandemic, driving all kinds of upheaval in demand planning, in logistics networks, in inventory systems, but there's always other issues that emerge.

That might be politics. Our colleagues in the risk team have mentioned over 70 elections in the coming year. Every election brings a risk of change in policy, whether it's trade or industrial or labor relations that can cause upheaval in supply chains. You can get exogenous events, the war that we see in Gaza or in Ukraine.

Then you've always got things like natural disasters, financial failure of suppliers. These are all things that pop up now and again. Whilst the pattern of supply chains has returned to normal, you can't assume that everything is going to be quiet and stable and easy. That's why you need to continue to invest in resilience.

**Kristen Hallam**

As we've said before on our podcast episodes together, it's never a dull moment in supply chains, is it?

**Chris Rogers**

That's right. It's funny. My e-mail footer for ages was, "Supply chains never sleep, but they do try and take the weekends off occasionally."

**Kristen Hallam**

With the intro, I mentioned some resilient strategies companies are exploring including inventory expansion. What are the pros and cons of inventory expansion?

**Chris Rogers**

Clearly, having higher inventories provides a degree of security. If you've always got something on the shelf, then you can always sell it. In many regards, the lowest-margin product you can sell is the one that you don't sell at all.

But the period that we've just been through with empty shelves or, even more challenging, the nonavailability of some specific parts within complex manufactured goods. Semiconductors in cars is always the classic example that gets referred to now building up inventory. You've got more than just a few days of availability. It can be really important to ensure that your supply chain keeps running.

On the other hand, it's darn expensive. Every widget you have on the shelf is dollars that are not in the bank or not paying a dividend to your shareholders or money that you owe. When we're in a period of elevated interest rates, the calculus that goes into how much should I have on the shelf changes quite radically. It certainly looks like we're seeing companies really cut back their inventories.

The S&P Global PMI for manufacturing, the Purchasing Manager Index has shown inventories falling for 10 of the past 11 months. The inventory-to-sales ratio -- yes, the inventory-to-sales ratio that you see in our macroeconomic data has returned to long-term average. It's not above where you'd expect it to be if being safe was there.

We also see it in the financial data. We've just had the third quarter earnings reporting season. I can tell you nobody was saying, "Gee, you know what, we really need to radically build up our inventories." I think that is very much that financial cost aspect overweighing the safety, the just-in-case element.

**Kristen Hallam**

Well, with rates being higher for longer, it looks like that trend will continue for the foreseeable future.

**Chris Rogers**

Our colleagues in the economics team will talk about that. We're not expecting interest rates to fall short-term, and, arguably, the era of free money that we had over the past, but really since the great financial crisis on and off, just isn't there. The finance department have a lot to say to the supply chain department at the moment.

**Kristen Hallam**

Sure. Another strategy that is mentioned in the 2024 themes report is source diversification. What has been the trend there? Do you expect to see more of the same in 2024?

**Chris Rogers**

Firstly, just to define some terms. When we talk about source diversification, we're effectively talking about having more than one supplier of a given product. Quite often, we've seen, both in the academic literature and in discussions in industry, it's often conflated with reshoring.

When I talk about reshoring, I have nausea, and we've talked about it on this podcast before, and we'll talk about it again, I'm sure, later on. But this could involve buying from more than one supplier in a given country.

It doesn't necessarily mean you're buying from a different country. It's all about having more individual suppliers rather than less. The reason you want to do that is to ensure that if one of your suppliers fails, you've got a backup that can pick up the slack. The pros and cons to that, pro, you've got some security. The con is you're putting less business through each supplier so you may not get as good terms so that economies of scale element.

The cost, again, with inventories, there's a cost associated, and the data that we look at would suggest that we did see a buildup. What we look at is the number of suppliers per buyer, and we do that within our bill-of-lading-based supply chain data set.

If we look at the top 500 U.S. importers, the number of suppliers they had increased by just over 10% in 2021 versus 2019. That would suggest using more suppliers to deal with disruptions. But in 2022, there was a 2% step-down.

Then in the past 12 months through the end of September, we've actually come all the way back down to 2019 levels. All that suggests to me is that, actually, diversification was a temporary must-have and is not necessarily something that we're going to see as a long-term trend.

Looking into 2024, we can certainly say, absent some sort of shock event, companies are probably going to be focusing more on reducing costs than increasing security. If anything, we might see that number of suppliers come down further.

Clearly, within different industries, there's different trends. For consumer durables like furniture, appliances, and so on, there's been a more rapid drop than average, which you'd expect because demand is down and profitability is down in those areas.

**Kristen Hallam**

No one's rushing out to buy sofas because they can't go to concerts anymore.

**Chris Rogers**

That's right. That's right. Although the -- a lot of companies are talking about, particularly in electronics, funny enough, looking over the next couple of years that they expect growth because of a replacement cycle.

Less so for a sofa because you don't tend to buy a sofa every 3 years unless your kids wreck it of course. But certainly, for electronics, most computers have a life of 3 or 4 years, similar televisions, and so on. 2024 is 4 years after the start of the pandemic when a lot of this spending started. We may see a pickup and a lot of that activity.

**Kristen Hallam**

One to watch. Reshoring is always a favorite topic when you appear on the podcast. Of course, I have to have a reshoring question for you. Where, meaning in which countries, are we most likely to see investment in reshoring in 2024?

**Chris Rogers**

The first point to make is that these decisions take years to implement and often take years just to decide on. When we speak to our customers in the supply chain world, they do very much think in terms of 3- to 5-year brackets.

The bracket that we're in at the moment has a couple of interesting endpoints during 2024. As I mentioned earlier on, there's a lot of elections coming up next year, so a lot of the policy mix that's out there is going to change.

If part of your decision about reshoring is, "Do I have friendly policy or not?", you're going to have to make some tough decisions on that. Obviously, with both the U.S. and Mexico having elections coming up as well as a lot of European states, there's some tough decisions to be made.

What we may see is companies choose to reshore to countries that are, how can I put it, less controversial in terms of their geopolitics. We've written a lot about India as a location for reshoring. In fact, we've written, earlier in the year, what we call a Look Forward journal so all of our colleagues across S&P Global got together. We found that India is a really exciting market for reshoring, not just because of its general geopolitical friendliness, but because it's a big market in and of itself.

Moving to India to supply India and also have the opportunity to export elsewhere, particularly as a second string, so you're supplying from, let's say, mainland China or Mexico or Turkey or whatever to look to move to India as well.

The Southeast Asian countries have continued to be popular, particularly Vietnam, but we're starting to see Malaysia and Indonesia become more of an area of interest as well. Malaysia has been a long way down the track on electronics. We may see other areas there. Indonesia is the home of a lot of raw materials is also increasingly trying to attract manufacturing for export purposes. I would say, India first and then Malaysia and Indonesia as areas of interest.

**Kristen Hallam**

As you said, all of this comes at a cost, it all has a price tag. Are there certain industries that are more likely to make these investments and resilience?

**Chris Rogers**

It's slightly tried to put it this way, but companies and industries that make plenty of money that have had plenty of problems are more likely to make the investments going forward. The automotive industry is an obvious one. With the autos industry, that comes at the same time as this ongoing shift to electrification where you can review your entire supply chain stack in one go.

Similarly, the electronics industry, and I mean everything there from semiconductors through to finished goods like smartphones and computers, go through a continual process of review. Because their products evolved so rapidly, there's a continual review of that supply chain ongoing.

At the other end of the scale, some of the lower-margin industries, particularly those with relatively simple assembly requirements, are actually probably looking less at resilience investments. Think about industries like apparel, some of the larger consumer goods that we talked about earlier like appliances and furniture, we'll probably see less of that from them as well. Those are the industries I'll be thinking about.

**Kristen Hallam**

For 2023, we had a separate theme focused on labor, reshuffling labor markets. For 2024, labor is really baked into our five themes. How is labor baked into supply chain resilience?

**Chris Rogers**

Clearly, supply chains don't work unless there's people to make them work, much as there's a continuing push towards automation. But we've had a very important lesson or a reminder this year of the disruptions that can be caused by labor to supply chains in the U.S. with the United Auto Workers strike, which we've written plenty about. I'm sure there'll be plenty of business school reviews of them done as well.

But labor as a source of disruption risk is clearly one of the major factors that supply chain managers have to deal with. It's not just strikes in your own factory. It's obviously strikes at your supplier's factory.

We're seeing at the moment, for example, wide-ranging strikes in Bangladesh that are going to have a marked impact on the apparel industry directly but also indirectly on the textile industry. Things like soft furnishings for homes, for example, that's where labor comes in.

Now, the resilience approach is, a, be nice to your employees and, sub-note a, pay them more. Now, the challenge there, of course, is if you pay them more, that's then another cost that you've got to bear at the same time as paying for resilience, paying for higher-interest costs, possibly paying for higher-tax costs as well, depending which country you're in.

I would say, striking that balance between making sure your labor is paid fairly on the one hand, and we will want to be paid fairly. Well, we want to be paid more than fairly clearly, but making sure also that labor is involved in those key decision-making areas is vital.

I think, again, coming back to that United Auto Workers as an example, the big three automakers are now going to involve the unions a lot more in their long-term supply chain decision-making, where do they make stuff, which factories do they open, which factories do they close? That may, hopefully, when the next set of these negotiations happens in 4 or 5 years' time, lead to fewer disruptions.

**Kristen Hallam**

Time will tell.

**Chris Rogers**

Exactly.

**Kristen Hallam**

Now, what are some of the questions that companies need to be asking when making decisions about whether to invest in some of these resilient strategies that we've been discussing?

**Chris Rogers**

You shouldn't really be asking "whether" but "how", and how much are you willing to spend? Clearly, if you manage to sail through the past three years with no disruptions and you're not worried about any of the future risks that we've talked about or other folks who have been on the podcast who I've talked about, then that's great.

But for everyone who's living in the real world, planning for the future is really important. I think the starting point really needs to be, "What is the cost of the disruptions that you might face?" Make yourself a list of the disruptions. What could they potentially cost you in terms of lost output, reputational damage, all of those kind of things? That will then give you a starting point to say, "How much do I need to spend to offset those costs?"

That involves, in turn, deciding which strategies offer the best return on investment. I work closely with our colleagues in our telecoms, media, and technology research group including 451 Research, and they do a lot of surveys of customers around supply chain technology.

Number one is always we need to understand the return on investment. If costs are high and money is tight, looking at strategies with a low direct return on investment but a big knock-on effect need to be borne in mind as well.

It's why we're so keen on encouraging companies to look at the technology aspects of their supply chain. These are areas where there are easy fixes where you can rapidly identify the golden outcome, which is, "We improved resilience and cut our costs."

Those times where you go, "Actually, we've always used this one supplier. But now that we've gone out and looked at all of the other suppliers, we found these three other ones that are way cheaper. Just that kind of review, discipline can be really important.

I think related to that as well, a key question that needs to be asked is, "We might be comfortable with our own position, but what about our key suppliers and our key customers?", trying to get inside their head a little bit, try and work out where their failure modes are and ways that you can either mitigate those or even have plans in place to help in the situation that your suppliers or customers struggle as well.

**Kristen Hallam**

Chris, any final thoughts on supply chain resilience for our listeners?

**Chris Rogers**

Disruptions are inevitable, right, whether they happen today or tomorrow. In 2024, the main risks we see for supply chains are in the field of politics and in parts of logistics networks, particularly anything that relies on the two big canals.

Resilience isn't cheap, and it certainly appears that many companies are choosing not to spend. I think it's inevitable that we're going to see specific companies and specific industries face problems next year. Those that do spend, even if it's only on small technological enablement for resilience, they may face some short-term costs, but it could lead them to be long-term winners in their sectors.

**Kristen Hallam**

All that's left for me to do is to thank you, Chris, for sharing your insights with us. Thanks to you, our listeners, for tuning in. If you'd like a copy of our 2024 themes report, please use the link in the description of this episode, and join us next week to learn more about what we see on the horizon for 2024.

**Unknown Attendee**

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