



CONCERNING CORONAVIRUS

Managing your supply chain in a time of crisis

The continued spread of COVID-19, or the novel coronavirus, has been both swift and extensive in impact. For all businesses, this pandemic must be viewed as a health crisis first and foremost, and our top priority must be to care for the well-being of employees and customers, assist those afflicted and mitigate the speed of transmission.

Even as businesses seek to protect their workers, they must also contend with serious gaps in supply driven by quarantines, labor shortages, and travel restrictions that have slowed or shut down supply chains in affected countries. As these widely publicized supply-side issues continue to shake confidence in markets, we are also seeing steep declines in demand in industry verticals ranging from consumer goods to industrial products.

As manufacturers and their private equity sponsors assess the state of their supply chains, we've put together this brief guide for those looking to navigate through this uncertain time and implement strategies for protecting their business going forward.

A UNIQUE DISRUPTION

Most companies and executives are used to dealing with risk that is bounded – whether it's geopolitical or environmental, risk is often understood to be exclusive to one country or region at a time. The novel coronavirus presents a unique challenge in that the risk is unbounded, since the disease spans across borders and has no clear end in sight. This makes the business impact all the more difficult to understand or qualify, since a country unaffected one day could be the site of the next outbreak.

In our globalized world, supply chains have become so long and complex that most have or will see some exposure to the outbreak. Companies should always protect themselves against single sources of supply, and yet, the COVID-19 outbreak has made a number of supply chain diversification methods seemingly ineffective.

Vertical diversification – where key processes in the production value chain are farmed out to separate, specialized suppliers who may even be in different countries – now makes a

company more vulnerable to volatility, where one hit to labor, raw materials, or components in any one of these processes can shut down the entire supply chain. Additionally, sourcing from alternate countries – while generally effective – becomes more of a challenge now, since any country can potentially become the next hotbed for the virus.

SHORT-TERM STEPS

Despite these challenges, executives cannot wait patiently for the outbreak to blow over – there are tactical steps you can take to mitigate risk and lessen the impact on your bottom line. We've found that aggressively managing suppliers and keeping in direct and consistent contact with the factory is key to handling a production slowdown. To establish this kind of robust communication, we recommend scheduling regular status meetings.

If the supplier is seeing significant labor shortages due to coronavirus, ask specific questions to understand the risk that your promised shipment dates could be further delayed:

- What is the exact number of workers that are currently absent?
- When are each of these workers scheduled to return?
- Where are the absent workers coming from?
- What scenarios would cause additional shutdown and for how many days?
- What plans have national or regional government entities announced for controlling the virus spread in factories in your area?

Once workers begin returning with some regularity, and the factory is nearing full capacity, it remains imperative that you continue to monitor production. When corresponding with suppliers, ask for priority by requesting specific details about your shipments. Have suppliers commit to ship dates and keep communication channels open to check their progress. The truth is, the squeaky wheel gets greased, and executives will need to be professional, but persistent, to get results.

For supply chains severely impacted by factory shutdowns, secondary sourcing could be an effective solution, but companies need to act fast. Sources in lower cost countries often reach capacity in times of crisis – this happened in 2018 when the tariffs hit, and we expect it will happen again.

Depending on the urgency of your situation, onshoring to the U.S. may also be a viable option. Of course, the practicality of this depends on your industry, since lead times and cost sensitivity can vary dramatically. For instance, manufacturers in the U.S. are known for their quick prototyping of high cost, low volume products – meaning temporary higher-cost production could be ramped up fairly quickly if need be.

LONG-TERM PROTECTIONS

In the early 2000s, companies rushed to source everything from China to take advantage of the low wages, until the cost of labor began rising and they realized the shortcomings of single country sourcing. The past few years have brought about a similar lesson, when the trade war between the U.S. and China resulted in tariffs that ate away at margins. The outbreak of COVID-19 should be taken similarly as a wake-up call for companies to diversify supply chains.

Alternate sourcing plans may be more of a challenge today because of the uncertainty of the virus' spread and reach, but the end result is still a stronger supply chain. In addition to alternative sourcing strategies, investors can also consider reconfiguring product flows to reduce lead times and improve responsiveness, take inventory out of the supply chain, or tightening cost-price linkages to stay ahead when disruption strikes.

Ultimately, the approach taken must be tailored to the needs of the company, so building out a comprehensive supply chain risk management program is essential. This entails identifying all internal and external supply continuity and cost escalation risks, and assessing the potential severity and likelihood of each affecting the supply chain. Then, determine a proactive approach to responding to each risk by asking:

- Where in the supply chain is this disruption likely to occur?
- How/why can it happen?
- What will happen during the disruption?
- What kind of corrective action would be required?
- What other supply chain configurations should be considered to mitigate these risk and cost issues?

Considering these basic questions is the first step in creating a proactive approach to risk management. Even if the risk presented by the novel coronavirus is unbounded, that shouldn't stop manufacturers or sponsors from planning a tactical response. If anything, unbounded risks like pandemics demand more consideration and planning when crafting an effective action plan.

VOLATILITY IS THE NEW NORM

Whether it's cost changes, natural disasters, tariffs, exchange rate fluctuation, or health crises, volatility has become the norm, so assuring supply chain responsiveness and resiliency is essential to maintaining margins and business continuity.

Adopting a series of best practices for risk management is vital to protecting your business now and in the long term. If this recent outbreak has taught us anything, it's that threats to a supply chain are often unexpected, and reacting in response to disaster puts you at risk when it comes to finding alternate suppliers – so don't wait to diversify. The coronavirus will pass, but other crises are sure to come.