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Operations restructuring for a post-COVID-19 world

During the last few months, organizations have faced extreme supply chain challenges that have stretched capabilities to the breaking point due to COVID-19.

In response to those challenges and ongoing pressures to be profitable, flexible, and cost-efficient, business models are shifting towards partnering with other businesses. This results in complex and intertwined third-party relationships that can be difficult to administer, as well as prone to risks.

Nontransparent supply chains and upstream operations can leave companies sightless, resulting in greater uncertainty and supply chain interruptions. Conversely, increased transparency contributes to demystifying questionable supply chains and allows companies to respond more quickly and more proactively to risks and operational inefficiencies.

Additionally, supply chain transparency aligns performance management across the entire organization rather than allowing each function in the organization to define its own performance goals. Siloed measures of success frequently work to the benefit of the function, but at the expense of the company. This lack of visibility and coordination might result in redundant investments, data fragmentation, or skewed priorities, and assuredly, result in companies not getting the most out of their operations.

This paper aims to explain how to tear down and rebuild your supply chain operating model to be competitive in the new reality of a post COVID-19 world.

1 A deconstruction of 'universal' truths

Supply chains were largely designed at a different time and for a different purpose, anchored on what was believed to be a set of persistent and universal truths. Either due to geopolitical or market forces these foundational elements are being challenged:

Accepted belief in the benefits of trade liberalization and global interdependency

The political sentiments that support free movement of capital and goods are receding in ways that transcend political leadership changes. For multinationals, the future will most certainly not look much like the past, with many relations likely strained for years to come. It may be time to revise growth and profit targets, reconfigure product mix, open up new distribution channels, and rebalance local/global responsibilities and decision rights.

Long-standing labor-arbitrage and cost-of-doing-business differentials

Twenty years ago wage cost differentials could be as large as a 40:1 ratio. However, the labor cost differentials and fiscal incentives that drove off-shoring have been eroding and will continue to do so. Additionally, automation plays an increasingly important role, reducing some of the previous need for high volumes of labor.

Confidence in leveraging tax-code provisions that can often align to offer advantage

Trade treaties being re-examined regularly and COVID-19 has accelerated this due to supply chain disruption. Companies cannot rely on these remaining in place as they are today and so need to rethink future strategies to ensure business continuity.

Sureness of super-lean operating models with inventory ordered on an as-needed basis

When the epidemic hit and supply lines ruptured, few companies had sufficient backup supplies in their supply chains to weather a disruption of more than a few weeks. The pre-pandemic ultra-efficient, just-in-time configurations, intended to reduce costs, also substantially increased risk. Of course there are inherent conflicts for business leaders. It costs money to carry extra inventory and invest in redundant supply chains – and there will be no immediate returns in the earnings statement to show for it. But the super-lean operating model that has boosted ROI now looks like a liability.

2 The acceleration of economic nationalism

From an operations strategy perspective, economic nationalism is best characterized as a bias towards self-sufficiency, controlling as much of the supply chain activity as possible within your local market. It points to a strategy of 'make-where-you-sell' and 'buy-where-you make' approach.

So in the medium to long term, companies are going to need to rethink nearly everything - their structure, their footprint, their third party partners, and their inventory strategy - in order to effectively win in the market.

There has been an increase in significant geopolitical events that have dramatically influenced the way supply chains are structured, such as in recent years the US-China trade relationship, the renegotiation of the North American Free Trade Agreement, and COVID-19. Each of these events triggered both intended and unintended consequences.

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.

3 The end of cosmetic surgery

A systematic overhaul of the supply chain operating model can no longer be elective surgery. Superficial tactics will likely yield piecemeal results and a skin-deep business resilience. There is substantial work to do - new capabilities must be built, not bought, and that takes time, resources, and attention to bring into reality.

It took three months for the world to go into lockdown. Closing supply chains down was simple; starting them up again is more complex. But getting your supply chain right is one of the biggest opportunities and value levers that your businesses has as you consider survival and sustained relevance.

4 Competencies required for the journey

Regardless of industry, maturity or size, there are specific competencies that may be critical to tearing down and rebuilding your supply chain operating model:

Leveraging artificial intelligence and big data to establish a robust supply chain resiliency platform

Forward-looking companies are investing in predictive supply chain risk platforms that allow advance warning signals by using AI, data analytics, machine learning and smarter supply chain technologies that predict disruptions stemming from a wide range of financial, geopolitical and environmental events. These solutions combine data from across the entire organization and combines it with external data from sources such as data providers, news feeds, and social media. These enabling technologies help change the questions from "What happened and why did it happen?" to "What will happen and how can we optimize performance because of it?"

Incorporating tax optimization into the footprint analysis

The optimal footprint should take into account not just the underlying operational economics, but also tax considerations. Supply chain changes - such as the relocation of people and functions across multiple geographies or a shift in goods entering or exiting markets - have direct and indirect tax consequences. Understanding the tax implications of sourcing, manufacturing, and delivery – including e-commerce - is critical to strategic decision-making.

Defining micro supply chains and applying true segmentation

Micro supply chains are "mini operating models" with flexible contracts and manufacturing closer to the point of purchase. This leverages decentralization and the ability to alter production and delivery, scale volumes, and introduce new products on short notice. Micro supply chains are also less vulnerable to macro phenomena such as volatile interest and exchange rates, tax regime change, trade tariffs and quotas, wage inflation and crop failure. The pre-pandemic criteria of supplier segmentation – contractual service level agreement (SLA) performance and spend – suddenly carry less weight. Instead, criteria such as impact to critical business operations, flexibility of services, and innovative ideas are central to a new segmentation process.

Embedding cost-to-serve as the foundational performance metric

To measure whether a company is using its resources efficiently, cost-to-serve calculations make visible how costs are consumed throughout the supply chain. Cost-to-serve is the cost analysis of all cost factors incurred to service a customer so that profitability by customer account can be understood. The Pareto principle, known commonly as "the 80-20 rule" can be applied to customer profitability. That means that an astounding 20 percent of your customer accounts may be draining 80 percent of your costs. Armed with cost-to-serve analytics, you will be able to see where you're making money and where you're losing money. With the insight of true cost vs. what you invoice your customer, you can make smarter decisions around pricing, resources, and process improvements.

Getting the "make-versus-buy" mix right

Companies need to carefully balance make-versus-buy decisions by analyzing trade-off in cost, capacity, flexibility, capability, and time. As with most important decisions, the make-versus-buy decision involves both quantitative and qualitative analysis. The ability to scale, access to a talent pool, capital requirements, strategic importance, and the ability to capitalize on innovation all factor in making that decision.

Driving purpose-fit inventory models: asset-light versus asset-heavy strategies

Determining the optimal level of asset ownership is tricky as both asset-light and asset-heavy can support, as well as torpedo, strategies. Asset heavy companies own much of their fixed assets which gives them greater control, but at the expense of tying up significant capital. In contrast, asset-light companies invest less capital and "pay rent" to access assets. Through this arrangement they gain greater flexibility and are able to respond more quickly to changing market demands and technology advancements.

Unpredictable, high-impact events are inevitable, given today's global business environment. One of the best ways that companies can prepare for a more resilient future is to continue to elevate the supply chain function to become a true strategic partner in the enterprise. A lot of companies have neglected to do the hard work around restructuring their supply chain. And they've got good reason because it is in fact hard to do; it represents significant strategic, operational, and financial challenges. So those companies instead resort to more piecemeal contingency plans and superficial risk management tactics, which, predictably, yields piecemeal results.

Organizations that will emerge the strongest are those that see an opportunity for a systematic overhaul of the supply chain operating model.

Where to start?

Deemphasize efficiency and lowest-cost as the dominant definer of value, in favor of a framework that assigns more equal weight to risk exposure, supply alternatives, tax considerations & channel complexity. These five actions can put you on the right path:

Redefine your 'measuring stick'

In the new normal, companies need to stop evaluating supply chain purely from a cost or service level perspective. While costs and service measure will remain, these need to be augmented with measures that assess the ability to be intelligent, agile and responsive to customer needs. Intelligent supply chains are segmented based on customer needs and have an ability to capture and propagate signals from the outside world to trigger required actions internally.

Understand your exposure

Companies should look at how fragmented their supply chain is. This should be across suppliers, distributors, and other third parties, looking at key indicators such as where are they located, what markets are they operating in, and the raw materials being used. Understanding the risks they carry and help you plan for the future. What is the impact on your business if your cost to serve goes up by 10%, what happens? What is the business impact?

Identify your constraints

What fixed investments do you have? What is outside of your control? Many businesses are seeing fragmented customer bases, raw materials being cut off and financial concerns that put constraints on their supply chain. Having a strategy that can be adapted where needed will help you weather future complications, even those problems you cannot control. For example, if a material you need is no longer available, what are your alternative solutions? Do you have other suppliers you can use?

Model the scenarios

Companies will likely need to model scenarios based on exposure and constraints in order to create scenarios up front. These scenarios and related action points need to then be discussed internally and with channel partners. This will not only help in being better prepared but also help ensure faster response times across the supply chain.

Separate 'no regrets' from 'do later'

As with any crisis, COVID-19 is likely to place a number of demands on how the supply chain should change. Smart companies will assess each opportunity with a value lens and prioritize areas that require immediate attention from the ones that can be done later. This is especially important since companies need to pivot to a new way of managing their supply chain while continuing to serve their customers. Picking too many things at the same time is likely to lead to an overload on management and not deliver the desired results.

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KPMG has more than 2,000 supply chain, strategy, and value chain management professionals from KPMG's network of member firms worldwide. We 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.

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