From reaction to action –
Supply Chain Resilience and Agility in a COVID-19 World
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The coronavirus pandemic has already fundamentally changed global trade in the short term and its influence looks set to persist in the longer. Leading multinationals have already begun to re-engineer their supply chains to ensure immediate resilience and agility and the lessons learned in doing so are of value to any organisation looking to optimise its mid and long term supply chain strategies.
The short-term: maintaining cash flow along the supply chain

The immediate response

A key element in maintaining the health of a financial supply chain is the cash position of the anchor buyer. In this regard, some corporates have shown exceptional agility and speed. This applies not just to optimising their cash but also adapting their business models and product lines to ensure continued cash generation. For instance, major manufacturers in the UK have been quick to repurpose their factories to produce protective medical equipment, which apart from helping to maintain cash flow has also demonstrated corporate social responsibility. This sense of responsibility has also applied to these corporates’ approach to their supply chains, where there has been a significant increase in the pace of onboarding of suppliers to supply chain financing (SCF) programmes.

While trade flows initially declined sharply, there has already been a significant recovery. This has been accompanied by a greater number of suppliers actually taking advantage of their ability to draw payments early under SCF schemes. In addition, a growing number of elective suppliers that previously chose not to join schemes are now doing so. In both cases, the existence and flexibility of SCF may have been critical for suppliers from certain countries that might have struggled to find alternative funding sources domestically. Collectively, this has driven a need for banks to be able to deliver fast track approvals of limit increases for schemes and to expedite onboarding of suppliers.

Leading corporates have definitely put considerable effort into ensuring their own cash flows and those of their key suppliers have been as robust as possible despite the impact of COVID-19. Nevertheless, at the same time they have not lost sight of their environmental, social and governance (ESG) and sustainability priorities in relation to their supply chains. As at least one recent example highlighted, the consequences of neglecting this can be severe in terms of share price sensitivity.

While COVID-19 has obviously been the primary focus for many corporates in recent months, the global trade environment beforehand was already challenging. Increasing geopolitical stresses with trade relations were driving a greater need for supply chain flexibility, as some corporates were looking to de-risk by partially switching sourcing to other countries in Asia and away from China. This in turn meant that they also expected their banks to be able to support this transition by migrating their SCF schemes to suppliers in new countries. Those corporates with banks capable of doing this therefore also enjoy a longer term future proofing benefit in this regard.
Improving risk controls

The need to track the whole value chain of a business to help reduce the impact of future external shocks, is now more important than ever. While some corporates have been improving, many organizations still only rely on spreadsheets to predict, monitor, record, measure and report on supply chain disruptions.

One of the keys to improving supply chain risk management is greater transparency and there is an increasing need to have actionable insights to be proactive rather than reactive. COVID-19 has considerably accelerated the process, with 44% of businesses saying at the height of the pandemic that their top priority was increasing the transparency of their supply chain. As a result, a growing number of them now have far greater clarity, not just on their immediate suppliers, but also on those at several steps removed. In exceptional cases, some already have complete transparency right back to the start point of sourcing raw materials.

This greater transparency has resulted in some corporates realising how acutely dependent they are on small suppliers at several steps removed from them along the supply chain. In some cases this has even driven them to acquire those suppliers because of the critical nature of their supply and/or the difficulty of replacing them. Other remedies have included moving from a just-in-time model to a just-in-case model, overstocking to provide a buffer to uncertainty. This has been supported by major injections of cash into supply chains, such as via advance payments, and in some cases easing of credit terms for customers as well.

This greater transparency has also proved useful in reducing some of the reputational risks mentioned earlier. As both consumers and shareholders have become increasingly averse to poor environmental and human rights practices, corporations have made use of the greater transparency they have gained to ensure ethical and sustainable sourcing practices are maintained throughout their supply chains.

However, despite the substantive recent progress made by leading corporates in improving their supply chain transparency, more generally there is still much to be done. It therefore seems likely that COVID-19 will continue to act as a spur to greater investment in technology and processes to ensure that businesses have visibility along their entire supply chain and not just as far as their most immediate suppliers.

The banking response

The coronavirus pandemic has put further pressure on business with an increase in the trade finance gap. The B20, WTO and the ICC issued a joint statement warning about a trade finance shortfall of between USD2 trillion and USD6 trillion that could impede the ability of trade to support the post COVID-19 economic recovery.

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1HSBC Navigator Study, May 20
2WTO, ICC and B20 Saudi Arabia joint statement Jul 2020
The quality of response from individual banking partners has obviously had a strong bearing on how effectively corporates have been able to maintain the resilience of their supply chains in the face of COVID-19. Fast track approvals, credit limit waivers, loan extensions, trade credit insurance limit reviews and other items have all been germane. However, the pandemic placed particular demands on the flexibility of response in relation to global supply chains because of the different emphases of governments around the world. For example, some demanded loan extensions, while others introduced government-backed loans coupled with fast track approvals, while others favoured different mechanisms or a combination thereof.

For banks working with large multinationals, this necessitated setting up diverse processes and technology to cater for all these requirements and to manage them in a globally consistent manner. By doing so, they were able to help deliver optimal supply chain support for clients in accordance with local governments’ mitigation strategies and requirements.

While banks have historically focused on this sort of financial facilitation, the pandemic has seen some go a step further to provide broader practical support as part of the banking relationship. One example of this is where a bank has exceptional visibility of large corporate supply chains because it not only has a wide geographical network but also banks a broad size range of businesses, from multinational to SME. Some have leveraged this to provide multinational clients with detailed supplier mapping, which has considerably expedited their attempts to improve supply chain transparency.

To provide enhanced financing to suppliers of companies that produce critical medical equipment to support the fight against coronavirus. HSBC and the Asian Development Bank (ADB) have formed an important public-private partnership that could enable up to USD1.2bn per annum of additional trade by SMEs.

**New collaborations**

In addition to certain banks providing supply chain support in new ways, the crisis has also triggered new collaborations within major multinationals. SCF schemes that have been extremely effective often feature a close collaboration between treasury and procurement. While procurement has been very much front and centre during the pandemic, one of the reasons that onboarding of suppliers to schemes has accelerated is because of this collaboration. To some extent this was a trend already underway, but it has accelerated appreciably in recent months, so that in some cases procurement is essentially the primary driver of new SCF schemes rather than treasury (although treasury is still involved).

Another new collaboration relates to sustainability, whereby corporate sustainability teams are not only far more involved in SCF schemes, but are now talking directly to sustainability teams within the partner bank. The obvious benefit of this is that sustainability becomes fully integrated in any resulting scheme from the outset, rather than just being a later bolt on, thereby helping to optimise the use of scare resources and production processes, facilitate product innovation, maximise efficiency and enhance corporate reputation.
Translating experience into medium-term measures

Business models, warehousing and sourcing

Some corporates have been quick to move into completely new product lines during the pandemic, but others have also changed the way they access their end customers and the additional items/services they sell them. For example, those historically selling physical products have started to sell associated services, often with a subscription element to them. Others that have previously operated through distributors or retailers are now looking at (or have already implemented) direct to end customer models. Some are looking to do this through existing major online portals, while others are launching their own platforms.

In the short term this has been in response to declining sales through physical channels caused by lockdowns, but it also presents a longer term diversification opportunity, as well as helping to ameliorate the sales revenue impact of future pandemics. It may therefore become a permanent medium-term measure for some.

This transition also has supply chain and warehousing implications if corporates are to ensure that they have the right stock in the right place to optimise direct deliveries. They increasingly need end-to-end transparency at a component level throughout their supply chain. This also applies more generally, with some corporates shifting or adding storage in locations closer to countries that have emerged or are emerging from the first phase of the pandemic. Again, for some corporates this may become established best practice.

A similar shift applies to supply chains, where some corporates are reducing geographical distances - even if more local suppliers cost more - in order to reduce risk. While this near-shoring or ‘re-localisation’ is not entirely new, it has gained pace in recent months and may persist in the longer term as a risk management measure, although for some industries this may not be a viable option. (One example is pharmaceuticals, due to the need to ensure permanent global availability of drugs.)

However, this shift is not as yet fundamentally reversing the longer term transition of trade from West to East. This still remains underpinned by factors such as growing Asian middle income populations, growth in intra-Asia trade and more recently the greater impact of COVID in the US and Europe in comparison with Asia.
A five step response for working capital and SCF strategies

1. **Continue to focus on cash flows and balance sheet:**
   Government financial support will be withdrawn at some point, so this needs to be a priority now so the corporate can weather the transition. Measures will need to include running frequent 13 week cash forecasts, but may also need to encompass a more permanent implementation of measures originally adopted to preserve revenues during the pandemic, such as new e-commerce channels or direct consumer engagement.

2. **Building and maintaining a resilient supply chain:**
   Understanding and better managing supply chain risks has never been more essential, but this needs to become embedded practice and not just transitory. The first stage is achieving sufficient transparency along the supply chain to identify potential risks. Managing them may then take multiple forms ranging from building in redundancy by adding suppliers (e.g. the ‘China+1’ strategy), to injecting liquidity, to acquiring critical suppliers that cannot be easily replicated.

3. **Carefully managing inventory:**
   The risk of excess inventory causing the expansion of working capital to existential threat levels is very real. This makes striking the right balance between sensible agreed service levels with customers and not overstocking (which recently became prevalent) essential, as is optimising the location of inventory to support necessary changes in business model and/or end customer demand.

4. **Balancing credit risk and payment terms:**
   On the one hand, customers need sufficient credit terms to get back on their feet and grow their businesses. On the other, the risks of them failing are considerably higher now than pre-pandemic. That logically demands a discussion around how receivables finance can help bridge this gap to manage the new world of counterparty risk effectively.

5. **Technology, technology, technology:**
   All of the previous steps can be far more easily achieved through the intelligent use of technology. Across the board, technology could and should be used to automate and simplify processes. Both now and in the medium term, going digital is utterly essential if the enterprise is to survive and thrive.
Building resilience for the longer-term

Future-proofing operations and ensuring financial adaptability along the supply chain

Supply chain disruptions lasting a month or longer now happen every 3.7 years on average, according to research from McKinsey Global Institute (2020). So planning for systemic disruptions will be critical and succeeding in ‘business unusual’, will be underpinned by innovation, new technologies and funding support. Providing supply chains with greater agility, control and resilience to navigate the profound change in consumer behaviours and beliefs.

In the current volatile environment, there is clearly pressure to act quickly in certain areas in immediate response. There is also an understandable inclination to couple that with rapid changes to the corporate’s long term business model. However, a certain measure of caution is advisable. Long term structural change made without thorough prior investigation can be extremely costly and disruptive to unwind later.

Avoiding this trap requires thoroughly understanding the drivers in the market, with customers being at the core of this. Even in sectors such as retail, where deep understanding customer needs and behaviour is already commonplace, additional effort will be required. In other sectors, this will be an altogether bigger task if costly missteps are to be avoided. The drivers that determine what goods/services customers want are changing: it is not just about what the product is – it is also about how it is made and why the business is making it. There is also the impact of long term change in the relative importance of business sectors, with those such as hospitality, travel and tourism likely to wane. Some businesses in these sectors are in some cases already radically changing their business model and/or target clientele in order to remain relevant and viable.

The shift to increasing online behaviour, whereby a new segment of consumers became comfortable with online buying during lockdown, is an obvious factor to consider. However, there are others, such as companies that started direct consumer engagement for the first time during lockdowns moving beyond purely online channels. (For example, new out of town single brand warehouses may emerge staffed by manufacturers rather than retailers.)

Leading anchor buyers looking to ensure long term supply chain resilience are focusing on ensuring the financial health of all members of their supply chain – not just tier one suppliers. That requires complete supply chain transparency, so tools/services that can help deliver this are likely to increase in importance. Armed with that transparency, these buyers are then looking at ways of ensuring how they can cascade financing opportunities along their supply chain to those that need it. In some sectors, the transition from large to small suppliers can happen early in the chain, so (depending on the availability of local financing) this need is greater. One possible solution attracting increasing attention is a digital payment token that can be split up and streamed down the supply chain to provide dependable cost-effective financing, thereby reducing risk.
Strengthening strategic supplier relationships

Strategic suppliers are not necessarily always large companies and may be at some steps distant along a buyer’s supply chain. Therefore, while requirements for large tier one suppliers to ensure the resilience and sustainability of their own supply chains may have already been present in supply contracts, their enforcement is likely to become more rigorous in the longer term. Some major technology companies already send their own inspectors into supplier’s facilities to check on working conditions and wages.

While this is likely to become more commonplace practice, some anchor buyers appreciate that this not just about audit and enforcement. They appreciate that not all suppliers may have the resources to validate all their suppliers fully, so they accept that as the instigators of these standards they may need to provide assistance, such as with support programmes. Ultimately, ensuring robust and sustainable supplier relationships will be a collaborative process.

Digitisation to improve efficiency and visibility

Businesses are beginning to move away from semi-manual spreadsheet tracking of their supply chains and disruption monitoring. They are leveraging new technologies that provide a more automated and efficient ways to provide that visibility. In some sectors, such as food and clothing retailing, digitisation is already enabling anchor buyers to trace not only suppliers but also the location of goods. As yet, this only applies to certain items and is not yet universal practice, but it is an indication of what may possible on a universal basis in the future. COVID-19 has certainly added extra impetus to this, in addition to that already created by climate change.

41% of businesses say they will digitalise processing and adopt paperless documentation. Digital ledger technology (DLT) promises much in this regard because of the exceptional transparency available through shared visibility of the ledger to multiple participants. Buyers, sellers, shipping companies, freight forwarders, inspection agencies, customs officials, insurers and others can all track and update a shipment in near real time, which can also be leveraged to prevent unnecessary delays in the various stages of a trade transaction.

Furthermore, organisations such as the ICC with its Digital Trade Standards Initiative are facilitating wider industry adoption and helping to improve supply chain flexibility. This in turn means that should changes/additions to a supply chain be necessary (such as for improving resiliency) there is a growing likelihood that new participants will already be using DLT, thus facilitating change without damaging transparency.

However, while the technology to support digitisation of supply chains may be available, there is still a need for broad collaboration across multiple participants. This includes shipping companies and inspection agencies, but the most crucial entities are probably governments. Governments are particularly important because of their dual role as large buyers as well as being the source of law and customs regulation. In the absence of global multiparty collaboration with meaningful governmental involvement, the end result is likely to be isolated digital islands, when the ideal is actually a digital globe.

3HSBC Navigator Study, May 20
Looking back to move forward – support in a rapidly changing world

Fund earlier, deeper and smarter

When it comes to delivering SCF capable of supporting new supply chain models, trade flows and macro-economic shifts, the key precepts now are speed, depth and intelligence. Funding has to reach the suppliers that need it as soon as possible to support resilience. Those suppliers may also be several levels distant from the anchor buyer, so any funding solution needs to penetrate to a greater depth. Finally, that funding needs to be distributed intelligently so the key suppliers that most need it are prioritised.

COVID-19 has made many corporates really appreciate how supplier size is not necessarily correlated with business criticality. Therefore, small suppliers that may not be bankable may actually be disproportionately important. This category of supplier has historically tended to fall outside many conventional SCF schemes, so this creates a need for new financing products capable of supporting them. This will be critically important, with the global demand for COVID-19 vaccines. Impacting not just the major pharmaceutical companies, but also the many smaller business along their supply chains that support the production and delivery of an unprecedented order volumes.

Accelerating innovation and ESG along the supply chain

Another outcome of COVID-19 has been the acceleration of innovation in the supply chain - to the advantage of all participants. Certainly there are some who see it as a possible catalyst for the removal of (or at least drastic reduction in) physical paperwork. Again, DLT has much to offer here because it facilitates the development of financing solutions for the small yet critical participants mentioned above, because the transparency and certainty of its data gives banks the visibility and control they need to make informed credit decisions in shorter timeframes.

COVID has also shone a spotlight on the role and responsibility of corporates to tackle a broader set of societal issues such as inequality or social justice. Sustainability and ESG more generally also seem likely to be areas of greater innovation and activity in the future. The disruption caused by the pandemic has driven a growing number of corporates to look further along their supply chains when considering sustainability. It has also more generally had the effect of accelerating existing supply chain sustainability initiatives. By identifying and measuring key ESG criteria businesses gain a clearer view of the full impacts and vulnerabilities of their end-to-end supply chains. Reputational risks have been a factor here, but so too has the appreciation that the share prices of companies focused on climate change or ESG have outperformed during the pandemic.
To discuss your supply chain needs further, please contact your HSBC Relationship Manager or Trade Specialist.