

COVID-19

How CEOs can respond to the crisis and start building a resilient future

By John Jullens



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COVID-19 has become a global public health emergency, with over 127,000 confirmed cases in more than 115 nations. On March 11, it was declared a global pandemic by the World Health Organization. Around the world, countries are trying to contain the spread of the virus, banning foreign travelers, imposing restrictions on public gatherings, and asking people to just stay home. Schools and offices are closing.

The outbreak is also shaping up to be the biggest challenge chief executives of U.S. multinationals have faced since the global financial crisis in 2008. They must take action to help protect employees, customers and partners. And, as the epidemic spreads and the negative economic effects multiply, CEOs need to act quickly to protect their businesses.

In this brief paper, we discuss how companies can manage the immediate challenge to their business and also address the systemic risks that the COVID-19 outbreak exposes—risks that will not disappear when the COVID-19 pandemic is over.

Economic contagion



As with the outbreak itself, no one knows the extent of the economic disruption. But we do know that economists around the world are raising their estimates of the impact on global growth. As of March 10, KPMG's economists are forecasting a drop in U.S. GDP in 2020, due to the effects of COVID-19 on business activity. As the likelihood of recession rises, central banks in Europe and the United States have made pre-emptive rate cuts and governments are floating stimulus plans.

Economically, COVID-19's impact is unfolding on two fronts: a supply shock, as parts and finished goods from affected geographies stop flowing, and a demand shock

as consumers stop shopping, traveling and dining out. Already, airlines are flying half-empty planes and tourism is falling off sharply.

The outbreak has underscored just how much U.S. multinationals—and the global economy—rely on China. Back in 2003, when the spread of SARS set off alarms about global supply-chain disruption, China accounted for only 4 percent of the global economy. Today China accounts for 16 percent of global GDP. In those years, international trade increased dramatically and supply chains all over the world have become far more interconnected. This makes isolating high-impact events much less likely.

What-if scenarios

The pattern and extent of the COVID-19 spread is unfolding on a daily basis, and expectations about the economic impact are also evolving. Containment scenarios—with minor and brief business disruption—seem increasingly unlikely. It is not yet clear how well containment efforts will succeed in the U.S. In Europe, the outbreak is spreading despite strong containment efforts in Italy and elsewhere, and central bankers are bracing for recession. KPMG economists say that a U.S. recession could start in the second quarter and continue into the first quarter of 2021. In China, extensive measures finally appear to be stabilizing the outbreak, but it is unclear how quickly normal business activity will resume.

This is a warning of things to come

Even as they organize their response to the COVID-19 crisis, CEOs should understand that this is not a one-off. Perhaps nobody could have predicted that this particular outbreak could have caused so much disruption. But it is completely predictable that low-probability/high-impact events will continue to happen—novel diseases, severe weather, earthquakes, social unrest, banking crises, etc. And, in a deeply interconnected, global economy, the impacts of such events are increasingly unlikely to be confined within one country's borders.

Indeed, the COVID-19 outbreak exposes the systemic risks inherent in how global businesses operate. By creating super-lean, just-in-time global supply chains, companies have increased efficiency and made it possible to serve

How severe the economic downturn becomes depends largely on how long the pandemic lasts. If the outbreak peaks by summer, there would be an intensifying scramble to reroute supply chains around affected areas and a potential increase in the number of companies facing bankruptcy due to falling sales, according to the Eurasia Group, a global risk consulting firm. If the outbreak continues through the end of 2020, Eurasia Group expects a severe decoupling from cross-border trade and rising risk of a global recession. As of this writing, economists are divided on whether the pandemic will cause a global recession, but the odds are rising.

customers in all parts of the world. But, as COVID-19 has made abundantly clear, the hyper-efficient, low-cost-country supply model is not resilient.

When the epidemic hit and supply lines were threatened, few companies had sufficient backup supplies or redundancy in their supply chains to weather a disruption of more than a few weeks. In a recent *Financial Times* article, the head of a supply-chain mapping company said U.S. firms should be prepared for six months of disruption.¹

CEOs everywhere should take the COVID-19 crisis as a warning. It is time to confront the risks inherent in global business strategies and seriously consider reducing overexposure to any single source of supply or market that seems like a surefire source of growth.

What to do now

CEOs face immediate and longer-term challenges as a result of COVID-19. First, they must address the impact of COVID-19. This will involve protecting employees, helping customers and partners, and preparing for supply shortages and falling demand. At the same time, CEOs should make sure that they are building the strategic

risk-management capabilities to inform future strategy and better prepare the company for the next shock(s). In addition, for companies that are highly exposed to China, there are specific actions to take to get going again and recalibrate China strategy and operations (See Rethinking strategy, footprint, and partnerships).

Crisis Management

The most immediate priority, of course, is to keep people safe. Companies must take steps to make sure that employees take precautions—wherever they work—and have permission to “self-quarantine” if they believe that they have been exposed to COVID-19. Companies may also

want to limit travel and face-to-face meetings, and ensure that employees have the laptops and connectivity they need to work from home. Companies should be prepared to pay affected workers who must take a leave of absence, and continue their benefits.

Patrick McGee and Andrew Edgecliffe-Johnson, "[Companies' supply chains vulnerable to coronavirus shocks](#)," *Financial Times*, March 8, 2020.

In addition, companies must take steps to help their most important customers, channel partners, and other stakeholders withstand the impacts of this outbreak. This can involve waiving certain fees and penalties, increasing sales incentives, and providing selective financial assistance.

We see leading companies rising to this challenge. They are preparing for the impact of the pandemic and a possible recession by setting up crisis response teams, developing a range of business impact scenarios, and conducting financial stress tests to ensure business continuity.

Companies are setting up war rooms and SWAT teams that work around normal processes to make critical decisions, sometimes on an hourly basis. This is tacit recognition that organizational complexity and slow decision-making processes tend to get in the way. The emergency is teaching even the largest companies that they can move with speed and agility when they have to. This should be a lasting lesson that helps companies act quickly and decisively in all business conditions.

One of the most important things right now is developing mitigation plans for potential supply-chain disruptions.

Upgrade strategic risk management capabilities

It is not surprising that many companies were not prepared for an event like COVID-19. With standard approaches to risk-management, most companies had a limited sense of how vulnerable their lean supply chains could be. In the early stages of the outbreak, a survey of businesses operating in China found that 70 percent had no plan for a supply interruption lasting more than a few weeks.²

To build resilience against unpredictable events such as disease outbreaks, companies need to develop true strategic risk management capabilities that go well beyond the typical Enterprise Risk Management (ERM) process. ERM departments are very good at managing discrete operational risks—in, compliance, safety, ethics and accounting, for example. But traditional ERM is simply not designed for highly complex, low-probability/high-impact

With the outbreak in more than 115 countries, the threat of disruption is now global. Quick action now can help protect supply lines and businesses. For example, simulations can be highly effective in identifying potential disruptions as well as possible mitigation steps, such as identifying alternative suppliers, making engineering changes to product specifications, and exploring various emergency shipping options.

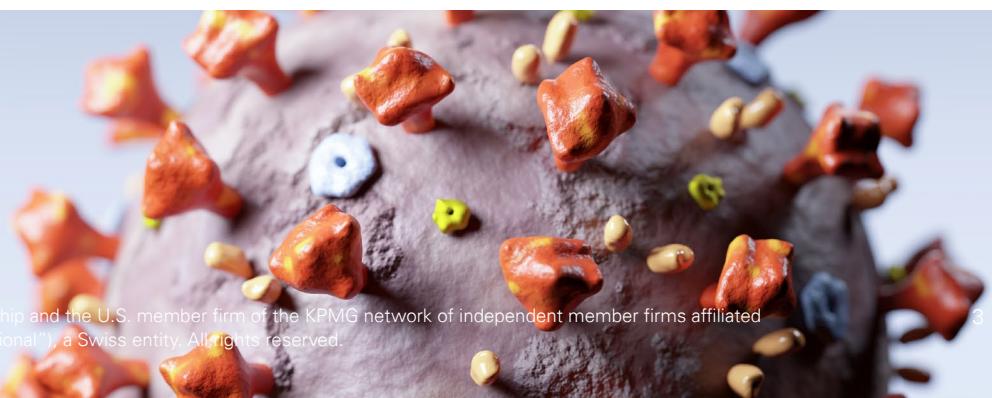
When trying to identify supply-chain risks, companies should look beyond the obvious. Typically, major disruptions stem not from high-volume and/or high-value parts, but from seemingly less critical commodities buried somewhere deep in the supply chain. For example, only when an earthquake hit in 2011, did automakers fully realize just how dependent they were on Fukushima, Japan for metallic paints.

Of course, we recognize there are inherent conflicts for business leaders in this situation. 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 potential liability.

situations, such as COVID-19. ERM departments also usually reside in a silo several levels below top decision makers, reducing their clout.

Companies can expand both the remit and influence of risk functions by more tightly integrating risk into strategic decision-making and planning processes. Many companies will need to build up analytical toolkits to model the impact of possible events, using simulations, war games or table-top workshops. Simulations, for example, can be used to understand all the ramifications of locating a plant in a particular city—including the potential impact of catastrophic events—or the likely payback on investments in supply-chain redundancy. The output feeds into strategic decision making and provides the basis for mitigation plans, which should be pressure-tested periodically for changing circumstances.

²Economist Intelligence Unit



Rethinking strategy, footprint, and partnerships

With the worst of the COVID-19 outbreak apparently past in China, multinationals can start to focus on restarting operations again. This will take some time and will be challenging. Supplier capacity will come back on line at different times, workers may not be available immediately or at all, and moving goods in and around China will likely prove difficult for some time to come. This is also a good time to ask fundamental questions about doing business in China. China is an increasingly important market for multinationals and remains a critical source of supply that can't easily be replicated. But ongoing changes in China—slower growth, credit and real estate bubbles, and a strained relationship with the U.S.—change the calculus for China strategies.

Do we need to re-assess our strategy?

For U.S. multinationals, the future will most certainly not look much like the past. Top-line growth will slow, and demand in China will continue to shift inland and down-market. Regulatory scrutiny will increase, and domestic players will become increasingly competitive. In addition, labor costs are no longer as attractive and U.S.-China relations will likely remain strained for years to come. This may result in at least a partial decoupling of the two economies. As a result, it may be time for U.S. multinationals to revise growth and profit targets, reconfigure product mix (e.g., premium vs. mid-market), open up new distribution channels, and adapt their organizations (e.g., rebalancing local/global responsibilities and decision rights).

Should we reconfigure our footprint?

As they adjust business strategies, companies will need to rethink operational footprints as well. Some plants, warehouses, and activities may need to be moved to China's interior regions, while others might be sent to lower wage countries, such as Vietnam. It may even prove beneficial to "re-shore" certain activities back to North America. The optimal footprint should take into account not just the underlying operational economics, but also tax considerations and the investments in, redundancies to make supply chains more resilient in a post-pandemic world.

Are our partnerships still working?

Part of the China reset should be re-evaluating partnerships. Do the existing partnerships still meet their objectives, given market, regulatory, and other changes? For example, in the auto sector, the Chinese government is gradually rolling back restrictions that require foreigners to enter through joint ventures and never become majority owners. Soon, foreign automakers may wish to establish majority control or even go it alone. In other parts of the economy, China is tightening rules for foreigners, potentially making local partners more important.

Conclusion

Unpredictable, high-impact risk events are inevitable, given today's global business environment. The COVID-19 outbreak is—we hope—an extreme example of how such events can affect businesses and economies everywhere. In this case, the impact includes a sudden turn toward a global recession. It will take smart planning, decisive action, and courage to bring companies safely through this downturn. It will also take courage and determination to make the investments in resilience that could reduce future low-probability/high-impact events to hiccups, rather than dire threats.

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