KPMG

Podcast transcript

Navigating through challenging times: global trade and supply chain considerations

Podcast with Doug Zuvich, Head of Global Trade & Customs, KPMG International, and Partner, KPMG in the US and Tim Sarson, EMEA Head of Value Chain Management and Partner, KPMG in the UK*.

Musical intro

Announcer:

Hello and welcome to the KPMG podcast series for tax, legal & mobility leaders.

As we announced in our last episode, we are focusing this podcast series on the ongoing global impacts of the novel coronavirus (COVID-19), and we will be looking at the tax, legal and mobility considerations and top-of-mind business issues that have resulted from this global pandemic. In today's episode, we are focusing on global trade and supply chain considerations.

COVID-19 has not only disrupted lives and businesses, but it has put the spotlight on underlying fragilities in the global value chain that drives economies around the world, reinforcing the importance of businesses understanding their supply chain, developing and implementing risk management strategies, as well as having contingency plans in place.

For this episode we spoke to Doug Zuvich, Head of Global Trade & Customs, KPMG International, and Partner, KPMG in the US and Tim Sarson, EMEA Head of Value Chain Management and Partner, KPMG in the UK.

When I caught up with Doug and Tim on the phone I asked them to share their insights on the global impact of COVID-19 on supply chain planning and value chain management before the global pandemic, during the current situation and what this space could look like in a post COVID-19 era.

Doug, Tim, thank you for joining us today.

Tim:

Hello.

Doug:

Hey guys.

Announcer:

Doug can you set the scene for us, by providing a snapshot of what global trade looked like before COVID-19?

Doug:

So, when COVID-19 outbreak surfaced, global trade was already being disrupted more severely than at any point in our lifetimes. We were watching nationalism and protectionist policies spread across the globe. Tariffs were being used for negotiation levers and for retaliation like never before. Multilateral cooperation was giving way to unilateral free trade deals, and ongoing disputes led by the US and China were opening a widening East and West split in the overall world trade order.

Announcer:

Tim, from your perspective can you set the scene for value chain planning pre COVID-19?

Tim:

In the world pre-COVID-19, I think it's fair to say things were already changing quite rapidly, and that was for a few reasons.

Concerns about sustainability and climate change have meant that massively extended supply chains and lots of global travel were already starting to come under threat or under challenge. People were operating more and more virtually, though it wasn't really reaching its full potential, but it was starting to happen and of course the companies that could reach customers digitally and remotely were taking a lead over traditional bricks and mortar companies.

So things were starting to change and of course in the last two, three years, we'd seen that the rise of geopolitics, of trading blocs fighting each other, of trade wars, of things like Brexit as well and so everything was all poised for a big change anyway before COVID-19 came along.

*All professional services are provided by the registered and licensed KPMG member firms of KPMG International.

Announcer:

So Doug, coming back to you, what have you seen change as a result of the COVID-19 pandemic?

Doug:

So now, we're seeing restrictions on exports, specifically of medical products, this includes all the personal protection equipment. We're also seeing certain pharmaceutical products being restricted for export. For example, India is restricting the export of certain types of active ingredients within pharmaceuticals. In the United States, we're seeing manufacturers shifting production of medical equipment through the use of the Defence Productions Act. We're seeing – consumer demand is softening so companies are now prioritizing savings over capital expenditures.

And we're also seeing that there's logistical challenges, right. Companies, supply chains are being disrupted and it's causing slowdowns. And that's really highlighted the dependency on China that we've had as a world over the last decade or so.

So, it's just a little more challenging and I imagine that it's going to cause even longer-term changes in global trade.

Announcer:

Tim, what global and domestic supply chain impacts are you seeing and hearing about from organizations due to COVID-19?

Tim:

The immediate impact on supply chains and value chains is really industry dependent and even within industries, it depends on the pattern of the company.

So to take a couple of examples, we've got retail, particularly food retailers who are finding that the just-in-time delivery model that they've been operating with for years just doesn't work when you've got an increase in 20-30 percent in your – overnight and in the demand for your goods, particularly basic goods.

The other end of the spectrum, I'm working with industrial manufacturing companies that have the opposite problem. They have massive invested capital and manufacturing capacity as well as storage capacity which costs them money just to maintain, their demand has gone through the floor.

So, for those companies, the problem is that they're seeing surplus capacity. If they're operating in certain industries where they can reconfigure what they're doing to meet the needs of this crisis, then great. Obviously, there are a number of pharmaceutical companies that are looking to do that, but if not, then they're essentially having to mothball their operations and that's very costly both in profit terms, but also in cash flow terms. That's already leading to some crises in some companies.

So it is a – it's a bit of a diverse picture at the moment, and then of course on the supply side, in terms of people, sick leave, the ability of people to either come in to work, to travel into work or to be able to work remotely, that's a whole – that's a whole other issue because, again, some companies are just naturally set up to do that. And I would include us, professional services as one of those where we've been getting used to working from home, working remotely for many years. Other companies, including white-collar services companies that just weren't, that were really reliant on people being in place and those are being really disrupted operationally at the moment. Their service levels are going through the floor. So, it's a – it's a mixed bag, but it – but one thing's for certain, things are not the same for pretty much for any industry or any company.

Announcer:

Doug, do you think there are specific countries that are experiencing the greatest impacts? And what are some of those challenges they are facing?

Doug:

It's fair to say that the impact will not be concentrated to one country or one region and that makes this a unique situation. As of early April, the United States and parts of Europe were the hardest hit, right, including Germany and France. The World Trade Organization (WTO), is expecting world trade to decline from anywhere from 13 to 32 percent in 2020, which is worse than the global financial crisis of 2008, 2009.

The World Trade Organization also predicts that exports from North America and Asia will be hit the hardest. Almost all regions will experience double-digit trade declines. And even for other industries, consumer demand is softening in light of the high unemployment numbers and uncertainty so that the purchases people would have made three months ago are now being delayed.

Announcer:

Tim, based on what you are hearing right now, which industries are seeing the hardest impacts?

Tim:

I went through a list actually recently and this was for our internal planning purposes just trying to work out, on a industry sector by sector basis, where was most of the pain going to be felt and which, if any, sectors were actually going to benefit from this crisis? And the fact is, when you looked down that list, 90 percent plus of sectors will be badly affected because even if you're not directly affected by lockdown, the world is going through a sharp, deep recession, as deep and as sharp as anything we've seen in our lifetimes and just as bad, if not worse, than what happened in 2008. So, you have to be pretty lucky not to be adversely affected by that no matter what industry you're in.

Announcer:

How important is flexibility and having a good understanding of your supply chain, as well as having contingency plans in place?

Doug:

Many companies learned during the US-China trade war the risks of being deeply tied to a single supplier or location. We saw a lot of importers start to move out of China, or diversify in order to manage the steep tariffs. COVID-19 reinforces that lesson. As of March, 75 percent of companies reported supply chain disruptions in the survey conducted by the Institute for Supply Chain Management and this is likely going to increase.

As factories in China slow down, manufacturers with a footprint in other locations were better able to manage the impact and to continue to adjust to the virus spread. So, for a long time, the focus for supply chain professionals has been on minimizing costs and reducing inventories, which often reduced flexibility. And we're now likely to see more emphasis on end-to-end visibility, using advanced technology like artificial intelligence and robotics to be connected to their full complete supply chain, again for visibility and for greater flexibility.

Also, we may see a shift to reducing dependencies on physical labor to technology, robotics and drones; the same way we had before, I think it's just going to increase more. And there will be increased cooperation with suppliers to create business continuity plans so that companies do not get caught in the same position that they are today with goods not being able to cross borders to get to where they need to be.

Announcer:

And Doug, what opportunities and incentives are you aware of for businesses, to support them throughout this period?

Doug:

So from a trade perspective, many jurisdictions are suspending tariffs or deferring tariffs on imports used to prevent the spread of the COVID-19 or to treat it. But in addition to that, like in the United States, there is a deferral process that allows – is applicable for companies that are in distress to give them some flexibility on being able to import so that they can sell and create revenue to be able to pay the tariff burden. So, I think there are – there is that out there. And many local custom authorities are also modifying import procedures so there are no – so there are less delays in processing goods.

Similarly, in some jurisdictions like Russia, they're temporarily suspending certain types of customs audits, there is less scrutiny there. So, now's the time for importers to really assess their tariff and duty profile and take a hard look at what strategies they're using to minimize and manage the impact of these tariffs.

And personally, we've seen a surge in duty drawback implementations globally; the drawback is where you import a product, you pay tariffs on it and you export that product or something similar to it and you get most of your tariffs back. Companies are realizing just how much money they're leaving on the table. So, we are seeing a lot of activity in that area as well as other tariff management areas.

And at a broader level, tax incentives and special purpose loans are also being offered to help companies get through this crisis period.

Announcer:

Tim, in times of disruption we often hear of companies reinventing themselves - are there specific industries where you're seeing this happen right now?

Tim:

I think it's really difficult to reinvent yourself overnight. If your whole business strategy was pointed towards doing things in a certain way and you weren't really changing, and a crisis comes along and it's actually companies like that that weren't already in the process of changing that are going to suffer most from this.

So, let me give you a couple of examples. When I was working on Brexit preparedness and I worked across a number of sectors, I noticed that there were –some companies that have greater diversity of supply and there's also a difference between those that are sourcing or near shoring their sourcing and those that were fully offshoring, as well as the difference between companies that have their own production so they have control over the means of production and those that were outsourcing.

Those companies that were a bit more diversified, they may have a bit more fat on the bone, so they may not have been quite so optimized from a working capital perspective, but they're more resilient now and actually they're on trend because that's been what companies have decided to do anyway because of US-China trade war, because of Brexit, because of other geopolitical changes.

So, another example is this move from face-to-face, bricks and mortar selling towards digital engagement, the digital engagement with the customer and that's not just e-commerce and people buying online. That's everything from marketing, from the way that goods and services are bought and sold, but also everything else about the way that enterprise engages not only with its customers, but also with its suppliers.

We're going to see a big acceleration of that, because what this has shown us is that you can't have a business model now that relies on individuals who are able to cross borders at will, who are able to travel wherever they want to, going on to sites and manually doing things. That was all – that was already not as cost-effective as being able to sell and deliver digitally. I think the big difference now is some of the fear of going virtual, the fear of going digital has to go away, because that's how people have to operate now.

So I think in the short-term, that means the further triumph of the digital giants, the online e-commerce platforms and so on, but in the long-term it means that everyone is going to pivot and of course some companies will do that successfully, some will move slowly and will be left behind.

Announcer:

Doug, is the current situation putting new pressures on existing or pending trade agreements, and if so, how is that playing out?

Doug:

Yes. So, North America is still moving ahead with the United States, Mexico, Canada implementation (USMC implementation), but there's far less momentum than we saw before the COVID-19 crisis. All right, companies realize that they have to be ready for the passage of this agreement and other agreements. It's on their horizon, they know they need to do it, but their immediate concern is to come off of that and move more towards just managing through the crisis. Making sure the base business continues to operate and that they can pull in cash as quickly as possible or delay spending the cash.

So, in the long term, we may see a pivot to protectionism as companies try to rebuild and assess how to best protect their economies and their people, especially if another pandemic occurs. In the United States, the Administration has previously said expanding and forcing FTAs would be a priority. The truth is, I'm not really sure how that's going to play out with everything else that's going on especially as we all start to look at little more inward in bringing some of this manufacturing back to local countries.

So, it's a little unsure. I imagine it's still going to – we're still going to push forward with free trade, everyone believes that free trade is good, especially if done right with good deals, but it just may not be the same priority that it was before.

Announcer:

Tim, what actions should procurement and supply chain executives take to minimize the impact of this pandemic on their businesses over the mid to long-term period?

Tim:

In the short to mid-term, the focus is all on cash, on survival and I think on keeping in touch with customers and with staff as well.

The danger with that sort of short-term survival mode, though, is that companies are being forced into quite fundamental strategic decisions, but doing it on a tactical time scale. Deciding where to cut costs in the supply chain or in sourcing, for example, you can make some quite bad decisions quite quickly. I think that's one of the important things is to have a view to the medium and the long-term when making short-term decisions.

In the long-term, it's really reading the writing on the wall, the future post-COVID will be more digital and we're going fully digital in many cases. The virtual organization is here to stay. So, we can't base, for example, our tax structure around the idea that we can fly a bunch of people into the right location, having their meetings there, make decisions there, flying them back out again.

And as well as that, supply chains are going to shorten. To me, that's probably less about simply shortening the distance between the factory and the customer and it's more about diversity, diversity of supply. This is what governments are looking at as well and not having over dependence on one part of the world or one country for key strategic products and the same is true for a multinational.

Announcer:

Tim, you mentioned diversity of supply earlier. How important is it that companies develop and implement supply chain risk management as part of their supplier relationship management (SRM) strategy?

Tim:

I think it's absolutely critical that supply chain risk management is included in your supplier management strategy, and that's across more than just not being over reliant on one supplier. This is in where you're supplying from, it's on how – in how you're supplying, it's on the commercial flexibility in your arrangements.

This is one of the big things that I learnt from helping clients for a couple of years on getting prepared for Brexit. A lot of – a lot of companies don't really have much of a deep understanding, if any understanding at all, of their – of who their suppliers are, who their supplier's suppliers are, and what the supply chains of their suppliers are.

So just actually getting to understand what it is that you're managing is absolutely vital and that's got to be the sort of core part of a risk management strategy, because risk is always – it always has been here, but this crisis has really shown it up as a – as an important thing that can't be ignored anymore.

Announcer:

And Tim, we are hearing that some leading scientists expect a second wave of the virus in September 2020, and potentially similar outbreaks to happen in the near future. What key learnings so far in this situation can you give to procurement and supply chain executives in order to be prepared for another disruption?

Tim:

So, this is an interesting one. Will there be a second wave and what will it look like? I think it's pretty hard to predict what happens with COVID-19. What I would say, though, is even if there isn't a second wave, a lot of the good practice that procurement supply chain managers, that planners generally within businesses can learn from this crisis and put into practice after this crisis are equally applicable to other sorts of crises that will happen down the line, because the fact is this isn't the last time the world sees a global crisis and there'll probably another one within the next 12 months that's completely unrelated.

So, I'm not sure that you can necessarily learn how to respond perfectly to the next wave of the virus because we're learning as we go along, but actually just building in understanding of our supply chain and then you can build flexibility in that supply chain that is going to be good for all sorts of different scenarios.

Announcer:

So Doug, can I ask for your thoughts on the future of global trade and the trends we can expect to see going forward after this crisis ends?

Doug:

So, we do expect global trade to rebound, but it's unclear at this point how quickly. It will depend on when the global economies can reopen and how they bounce back. But in the short term, there will be an increased pressure to manage and reduce costs, so we expect tariff and duty-saving opportunities to be a crucial component for many companies' business strategies especially as tariffs become a pretty significant cost these days.

We also expect to see governments designate products as essential and either requiring that certain amounts be produced domestically and/or limiting exports, and this may lead to complicated export regulations which require a company to understand how and why its products are restricted. And, as mentioned, we anticipate that companies will seek a diversified supplier base as a result, first, of the trade wars and now it's pretty evident the need due to the COVID-19 crisis.

And we also expect companies to look to where there is existing infrastructures to support production, right, so as they start looking ahead to diversify, moving towards where there is current infrastructure. And this is probably because resources and capital is really not going to be available to make large investments in truly developing markets.

Personally, I think – I believe – and there's some speculation out there that Mexico may benefit the most in the short run because of shorter lead times for shipments to the United States as a result of the implementation of the USMCA. And it also has a significant number of free trade agreements throughout – with Europe, with the EU, throughout South America and Africa with positions in, it's almost like a hub for free trade for companies. And again, it has a good infrastructure.

Announcer:

And Tim, to wrap up this podcast, do you have any thoughts on what value chain planning will look like after COVID-19?

Tim:

I've talked a lot in this podcast about physical supply chains, about procurement and supply chain management, the physical side of things. And I'm a value chain advisor, and actually, a lot the work that I do, a lot of that is actually about organization. So, it's about where people put stuff, whether that's physical plant or whether that's headquarters where teams are based and so on.

My prediction for value chain planning more broadly is that certain trends are just going to really accelerate. We're going to have to be dealing with and planning for virtual organizations where you have leadership scattered across a number of different geographies.

We'll see shorter supply chains. We'll see more in-country manufacturing. The shorter the supply chain, the more you have to work to really think about what is the role of the above market functions in a business, because if above market is no longer about coordinating with global set of logistics and supply chains, it becomes much more about pushing out a standard set of values, of brand principles, of ways of working, of operational effectiveness to each country even if each country is physically operating a little bit more autonomously than it was before.

So, we'll see a change in how the market and the above market work with each other and we'll see, as I said, an acceleration of digital business models. So, it was already the case that there was no such thing as a digital versus a non-digital business, because every business is digital to some extent, and that's going to increase. That's really the only show in town in the future. So, we'll see far more R&D investments in digital technology, in software rather than hard engineering, another acceleration of a – of a long-term trend, we'll see far more customer engagement that is online as well.

That allows us actually – in terms of value chain planning, that allows us to sell across border a bit more easily, but actually the corollary of all of this is of course tax authorities and governments generally are going to need to pay back the debts that they're incurring at the moment in order to bail out companies through coronavirus and they're going to do that by raising tax and getting more aggressive in certain areas.

Announcer:

And in terms of taxes, what sort of actions do you think governments and tax authorities might take post COVID-19?

Tim:

Well, I would expect to see a lot more things like digital service taxes pop up anyway, another acceleration of a – of a long-term trend.

And they will probably start competing with each other for foreign direct investment as well because they need to get investment going again to get their economies going. So, I'd expect to see targeted grants, state aid, particularly in countries like the UK that is coming out of the EU and is really needing to sort of find its place in the world. So, there will be new types of incentives. There'll be grants, there'll be heavier government involvement in infrastructure, in the way that businesses operate.

It's going to be a new paradigm for value chain planning, but that just means that we have to do things in a different way. It's interesting. It's not sort of positive or negative. It just means that it's a new paradigm that we're operating in and it will be interesting to see how things evolve.

Announcer:

Tim, Doug, on behalf of our listeners I would like to thank you for your time today. It has been really interesting to hear your perspectives around the impacts on global trade and supply chain management as a result of the COVID-19 virus.

Certainly, there is a lot for business leaders to consider, and work into their plans and practices as we move through this current situation and I look forward to continuing this conversation with other KPMG leaders in the coming weeks.

For more information and resources on COVID-19, visit home.kpmg/covid19taxandlegal

Join us again next time and please email us with any questions you have about today's episode at tax@kpmg.com and we'd also love to hear from you with any suggestions you have for future episodes.

Thanks for listening.

Musical exit