THE CPO AGENDA

THE PROCUREMENT AND SUPPLY CHAIN MANAGEMENT PRIORITIES FOR 2021.

THE FIVIS PARTNERSHIP.

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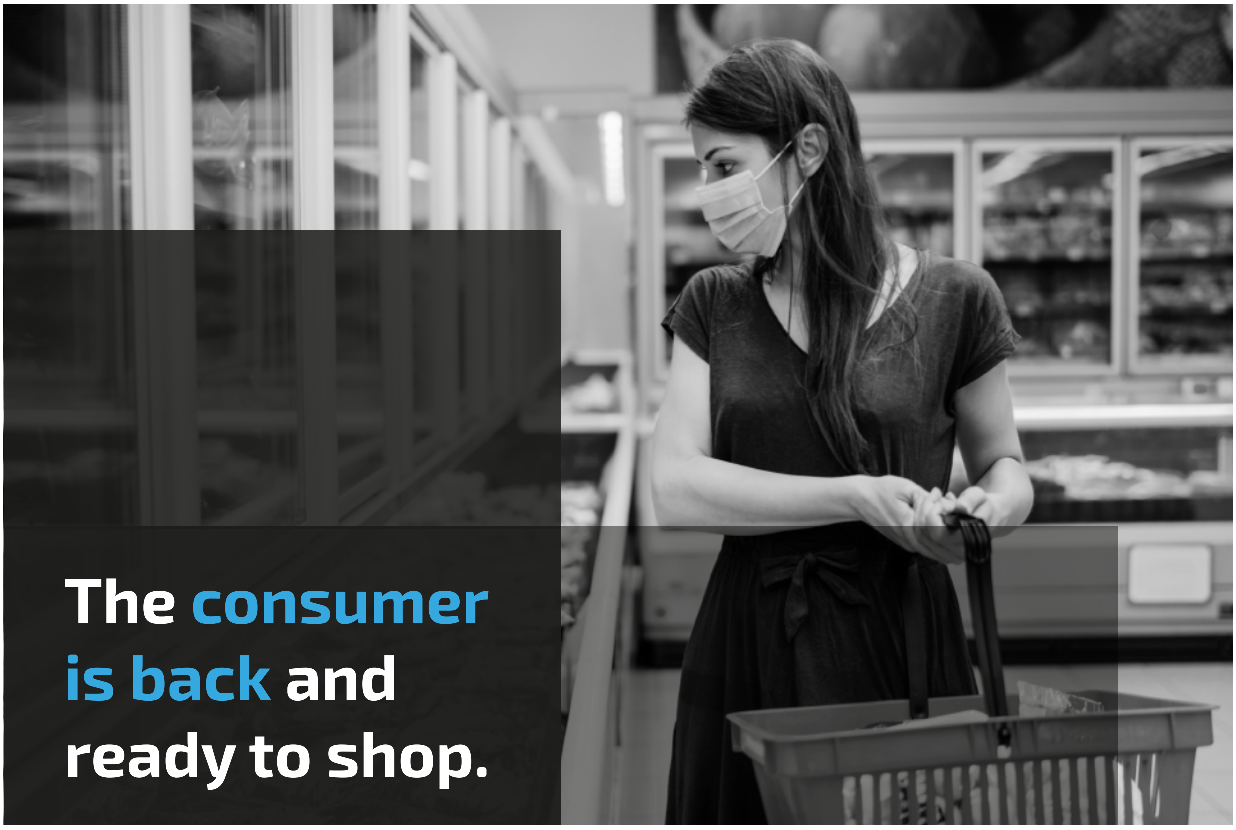


The consumer is back and ready to shop.

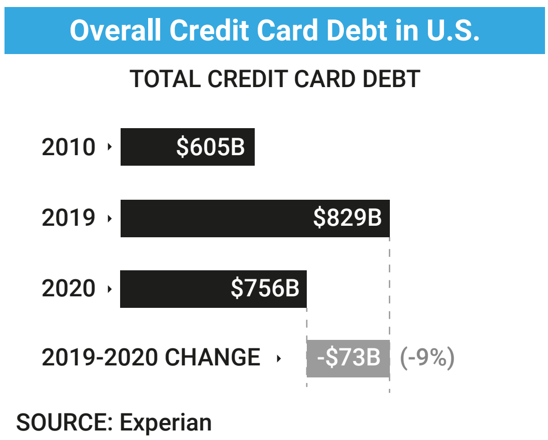
2020 was unpredictable and unprecedented. For buyers and supply chain managers alike, the past year was just a big, continuous course correction and firefighting effort. Relentlessly fluctuating demand and supply patterns led to a constant balancing act between protecting the company's cashflow, de-risking supply chains and quickly implementing new supplier solutions.

In 2021, the general expectation of company leaders and stakeholders is that procurement and supply chain professionals are clear and confident on their key priority. The main focus has to be to set up the supply chains for a returning customer that is eager and ready to shop, despite the still elevated level of uncertainty in the markets.

Whilst this might sound counter intuitive since most of us are still personally impacted from lock down restrictions and travel bans, end consumer demand will reemerge with a vengeance as soon as major economies reopen for business. Certain consumer behaviors will have changed of course, but nevertheless, old consumption patterns will come back to an extent and new ones will emerge. This combination could lead to a new wave of demand, much stronger than currently anticipated [0].

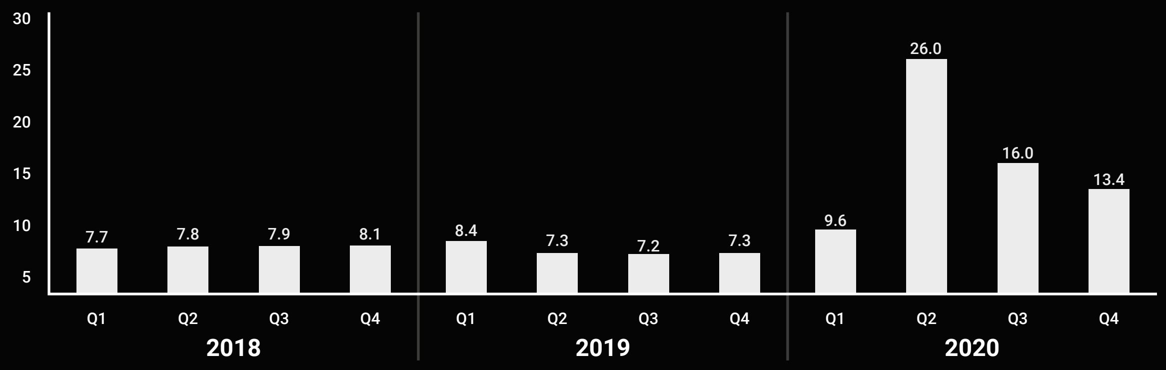
Certain macro and micro economic data provide some initial indications for what is about to happen and what to expect by summer or early autumn most likely with regards to consumer demand, and hence how procurement and supply chain teams should ultimately prepare.

First off, the private consumer has weathered this crisis surprisingly well. In the US, for instance, personal credit card debt has fallen by 9% since 2019 and to the lowest level since 2017, according to Experian a consumer credit reporting company [1].



First off, the private consumer has weathered this crisis surprisingly well. In the US, for instance, personal credit card debt has fallen by 9% since 2019 and to the lowest level since 2017, according to Experian a consumer credit reporting company [1]. During the global pandemic, households have effectively deleveraged their debt load and steadily increased their savings rates to record highs. Household savings currently hover around 13% of disposable income, despite interest rates being at practically zero percent [2] [18].

PERSONAL SAVING AS A PERCENTAGE OF DISPOSABLE PERSONAL INCOME IN THE U.S.



This translates into 1.4trn USD in purchasing power waiting to be released and put into private consumption in the US alone [3]. Many banks in the Euro zone report a similar trend with massive increases in bank deposits compared to pre-pandemic levels [24].

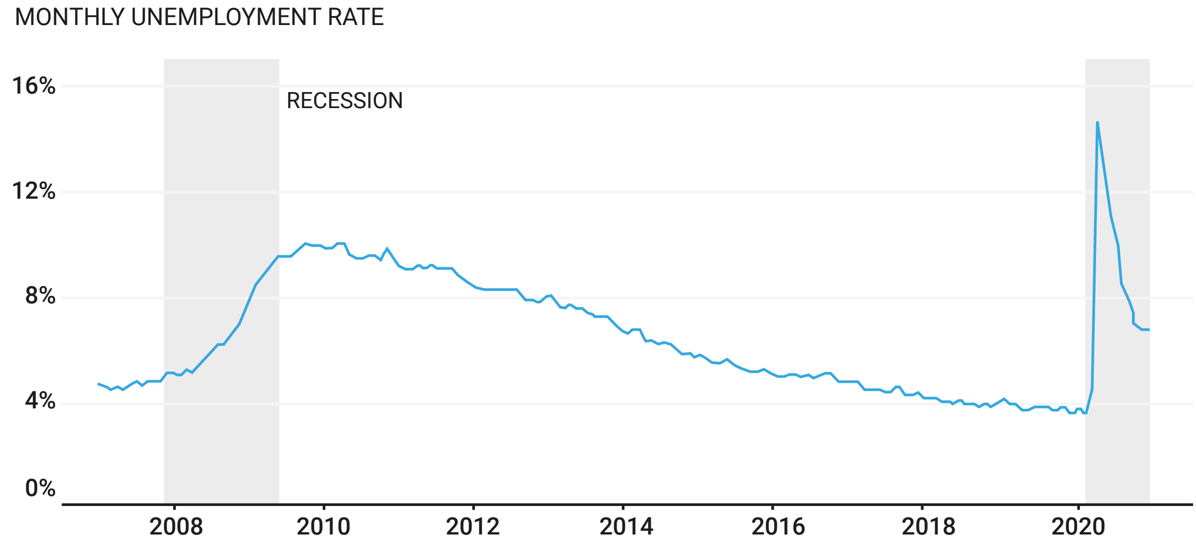
In many segments of the end-consumer economy, you can already sense an elevated, pent-up demand, especially in the leisure and travel sector. For example, according to a recent survey commissioned by one of the largest German tour operators, 50% of Germans are ready to go on a holiday this summer, even with some COVID19 restrictions still in place [4]. Tourism and leisure activities will have positive knock-on and spillover effects to many different sectors, driving up B2C consumption levels significantly.

From a company perspective, many businesses taken the opportunity during the crisis to restructure and operationally streamline their organization, reducing headcount, digitizing their processes and establishing new direct to consumer sales channels (e.g. Nike, Walt Disney). They have refinanced their debt and built up a financial war chest at rock bottom interest rates (e.g. Apple, Boeing). It is highly likely that at least a portion of this money will flow into R&D initiatives, new products and new ventures that drive B2B demand across industries [0].

From a public sector point of view, governments around the world are trying to outcompete themselves with massive public investment and stimulus programs, from building bridges and roads, over fueling the green energy revolution to business grants and direct checks to citizens [0] [6] [8]. These initiatives will increase demand for products and services [9]. For example, in the US, the monetary policies and fiscal stimulus programs amount to an unprecedented 5trn USD (December 2020). This represents 25% of annual US GDP that is pumped into markets. This does not take into account similar programs initiated by the EU, the UK, and Japan at similar record levels and any future stimulus packages currently being discussed within the new US administration (an additional 1.9trn USD is under review) [22]. The money supply surge in 2020 has already exceeded anything the world has seen in the past 150 years. Overall this represents a huge inflow of financial firing power especially when comparing it to the estimated 2trn USD that the public sector in the US spent (lost) to battle the great financial crisis back in 2008. Today's stimulus programs will to a large extent, find its way into the real economy and into end-consumer's pockets versus 2008 where financial support predominantly ended up with banks and financial institutions [5].

A crucial factor to consumption and to the overall health of the economy is of course the level of employment. Whilst the number of people currently out of work remains elevated, it is unlikely that we will experience a long period of high structural unemployment [6]. Especially in the hospitality sector where most jobs got lost, employment opportunities will return quickly, not to the levels we have seen in 2019, but enough to reduce unemployment rates significantly which will further elevate consumer confidence [19].

Jobless rate remains at 6.7% in December 2020



SOURCE: Bureau of Labor Statistics. Data is seasonally adjusted.

Lastly, from a public health perspective,the virus, as deadly and vicious as it still is, will be contained in the course of the year. The vaccination distribution is accelerating around the world, with promising further vaccines to be approved soon (e.g. Johnson & Johnson's one shot vaccine is due for approval in February 2021). There are currently more than 200 vaccines being developed still [20]. Some experts even predict a vaccine glut in the coming months [8]. New therapeutics and rapid testing regimes become more and more sophisticated and accepted, which will allow societies to open back up rather sooner than later [7].
All of the above could lead to a demand surge for products and services and it will surprise many business leaders and their respective procurement and supply chain teams that are unprepared.

Nothing is for certain of course, risks and volatility, throwbacks and unforeseen events will persist. A lot of unknowns remain, but the probability of a sudden demand surge playing out is steadily increasing. The possible outlook of us being at the potential starting point for a prosperous decade, the roaring 20s, or at least a roaring 2021/2022, should be top of mind of business leaders [19].

The fundamental question for procurement and supply chain management organization is hence:

Let's take stock of the state of our supply chains today and the challenges procurement and supply chain leaders are being faced with in the here and now.

Firstly, what is the level of readiness to restart our global supply chains? In 2020, many suppliers across various industries had to idle or curtail their production, furlough or lay off their employees. This has led and will continue to lead to bottlenecks and price hikes, especially when the aforementioned surge in consumer demand will kick in. Some of that production and supplier capacity might be gone for good or require significant lead time to fire back up.

This issue is prevalent, especially in the commodity space. Oil for instance, still being a fundamental driver of most economic activity, could be harder hit on the supply side than expected. Oil is the ultimate commodity and starting point for many supply chains in one form or the other. Oil production curtailments around and world leave many question marks if supply will ever come back to pre-pandemic levels. Especially the US portion of global oil supply with their, even before the crisis, barely profitable shale industry is being decimated. Oil exploration projects are already being reduced by all major oil companies as we speak, impacting future output further. This is accelerated by a change in policies in many economies around the world stipulating a greater focus on green sources of energy at the expense of fossil fuels [10] [11].

Other supply chains might not have survived the crisis at all and have already disappeared forever. Especially smaller suppliers with less ability to refinance their debt and to finance their cashflow during shutdowns might be at the brink of bankruptcy or will run into solvency problems rather sooner than later with government support schemes expiring.

Secondly, how quick will global supply chains be able to restart the physical flow of goods and services? The logistic network of shipping containers for instance that rely on a constant level of global trade to smoothly operate at reasonable cost are heavily disrupted already and will result in severe bottlenecks and logistic surcharges when demand moves higher [12] [13]. A lot of the global freight used to be transported in the body of passenger planes, whose overall number has been heavily reduced. Air carries will only gradually bring their capacity back into the market, further constraining a quick supply chain rebound [23].

Be wary of higher **inflation** and **currency volatility.**

These are not the only issues procurement and supply chain professionals should be wary of. As great as a returning customer will be for your company's top line growth, it will be equally as challenging to keep this wave of demand in check, not only physically through a reignited and functioning supply network as discussed above, but also from a financial risk perspective as we will outline below.

Stepping up the active management of financial risks and volatility will be one of the key focus areas for supply chain manager and procurement leaders in 2021 and beyond. The main reason behind this are the unique underlying macroeconomic conditions of the increase in private household demand combined with ultra-lose monetary policies by central banks around the world which will result most likely in higher rates of inflation. Mid-single digit percentages in this space are enough to raise concerns and are something that we have not really experienced for a good 10 years (predominantly in the developed economies). It might hence be unexpected, especially because of the fact that most economists rather see deflationary pressures as the most realistic scenario to play out currently [14].
If inflation indeed comes true, its potentially sudden increase will have direct and indirect knock-on effects on global supply chains with potentially severe consequences.

First, inflation will lead to the obvious namely higher prices for ingredients and services that procurement and supply chain teams' source, especially those that are linked to commodity prices which are most sensitive to fluctuations in inflation. Depending on the setup of your business, it might not be that easy to pass on these increases directly to the end consumer, which means the supply chain will be required to finance the cashflow. Given the current elevated debt position of corporations (see below) this might be a challenge for your company or other players in your supply chain.

Second, higher inflation might lead to higher debt refinancing costs for companies given its correlation with the corporate bond market which is one of the main sources of capital for companies. Only a small move in corporate bond rates could push some businesses over the edge, incapable to service their debt. The corporate debt numbers are at record highs, which makes this situation even more precarious. Non-financial US corporations owed 10.9trn USD as of Q2 2020, up from 6.4trn USD at the start of 2008. Global debt has increased significantly over the past year [17]. Some will argue though that central banks would step in and alleviate this risk right away through their bond purchasing programs. But will they really?

Third, major currencies such as the USD will become more volatile as a result of inflationary pressures which will impact pricing models and increase currency exposure risks for businesses that operate a global supply chain.

Your 2021 priorities in procurement and supply chain management.

As procurement and supply chain professionals, we are in the midst of all these moving pieces of micro and macro events, financial and non-financial challenges and the global health crisis. Nobody could prepare us for an event such as COVID19 in 2020. The aftermaths we experience now are something we can and should be able to plan for much better though.

Bringing the above points all together should lead into the following immediate priorities for 2021 for supply chain and procurement professionals:

1 FORM PARTNERSHIPS WITH THE CRUCIAL PLAYERS in your supply chain and link them closely to your operations to gain preferential treatment over competition and to assure supply and extra capacity for a returning consumer. Evaluate the production and delivery lead times of your suppliers, their flexibility to produce and supply, their logistics setup and reevaluate the underlying supply chain risks constantly.

2 SUPPORT YOUR SUPPLIERS WITH THEIR CURRENT CASHFLOW CHALLENGES and financial issues they face to avoid further supply curtailment in the market. The more production capacity disappears now, the more of a seller's market you will face in the years to come.

3 ENLARGE YOUR SUPPLY BASE to hedge your bets and increase supply flexibility. Consolidating spend into a single sourced supplier to create economies of scale should not the priority at the moment.

4 EVALUATE FINANCIAL RISKS EMBEDDED IN YOUR SUPPLY CHAIN with regards to commodity path throughs, inflation rates, currency risks, etc. It is not good enough to outsource the risk from your balance sheet to the supplier. Elevated underlying financial risks within the supply chain can wipe out supply and hence your ability to meet demand in a heartbeat.

5 As much as your company stakeholders want you to localize their supply chain to offset the early 2020 experiences of disrupted supply especially from China – now is not the time to experiment and forgo long established supplier relationships. SUPPLY ASSURANCE to match the potential demand surge later in the year is priority number one and your incumbent.

6 INFORM AND FORECAST PRO-ACTIVELY, constantly and swiftly. Currency fluctuation, especially on the dollar, will hit your cost structure. Anticipating financial volatility will help you to de-risk your supply chains effectively. A weaker dollar and stronger Euro look like the most likely scenario for now [16].

These suggested priorities are of course only based on assumptions which can be wrong. There is always a counter argument to any of the thesis outlined in this article especially in such uncertain times as today. 2021 will be for sure a volatile, uncertain, complex, and ambiguous (VUCA) year. It might turn out to be a completely different ball game after all, as this article with regards to inflation risks by Bloomberg argues [15]. However, it is reasonable to assume that given the unprecedented and globally orchestrated response to the demand shock that we experienced in 2020 will result in a similarly impactful response by the consumer that will retest our supply chains.

One truth is for certain though, you must carefully evaluate and assess your specific situation constantly. Form an opinion and make choices with regards to risks and opportunities within your supply chains. Maintaining a transparent and permanent dialogue with internal and external stakeholders will help you as procurement and supply chain professional to be aligned and ultimately prepared to the most likely scenarios your business has signed up for.

Define your priorities by building your best view on what will happen around you in 2021. I hope this article gave you some fruit for thought to establish your game plan to delight your consumer with excellence in 2021. Good luck!

Contact us if you need help in determining your procurement and supply chain priorities.

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