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The road ahead for global supply chains

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Technology, geopolitics, and COVID-19 could lead to a total reinvention of how goods move around the world

Click HERE to watch the Virtual Dialogue video.

The “Rules of origin” section of the World Trade Organization’s (WTO) website starts with a paragraph that begins thus: “Determining where a product comes from is no longer easy when raw materials and parts criss-cross the globe to be used as inputs in scattered manufacturing plants”.

Article 3 in WTO’s Agreement on Rules of Origin further spells out the country of origin in such cases as “the country where the last substantial transformation has been carried out”.

“What you’re now facing is a world in which if you have a label called ‘Made in China’, you would be subjected to punitive duties going into major countries such as America,” notes **Dr. Victor Fung**, Group Chairman of the Fung Group, a Hong Kong-based multinational group which comprises major operating groups engaging in sourcing, logistics, distribution and retailing. Elaborating on the U.S.-China trade war, he adds: “However, if you do the finishing in Bangladesh or Vietnam, you may actually use Chinese components that may still be a lot of value-add in the supply chain. The last stages of process confers the country of origin, and then you go in under a different duty structure.”

“So because of that geopolitical change, there’s been a complete rearrangement of the supply chain looking for appropriate countries of origin to finish the product. It’s been hit by the geopolitical change and the technology change, and now comes COVID-19.”

THE TROUBLE WITH COVID-19

Dr. Fung made those remarks at a recent SMU Industry Leaders Virtual Dialogue where he listed technology changes, geopolitics, and COVID-19 as the three factors that are threatening to turn global supply chains upside down. Whereas technology has an end goal of point-to-point digitalisation – “I would submit that most of [the global supply chain] is still quite analogue with maybe pockets of digitalisation” – COVID-19 brings into focus several issues."

“As consumers begin to think through the need for social distancing and less physical contact, you can see that consumer behaviour will put a lot of pressure all the way up the supply chain,” Dr. Fung points out, referring to the need to build a contactless retailing environment and a bigger e-commerce component within organisations. As more businesses are forced to generate revenue online, they will encounter customer expectations of 24- or 48-hour delivery windows that companies such as Amazon and Taobao have set as industry standards.

“There is no way you can manufacture far away, unless you are prepared to stockpile huge amounts, which companies are probably not,” observes Dr. Fung, who is also the Chair of the SMU International Advisory Council in China. “Therefore, that drives the need to manufacture closer to the consumer.”

Dr. Fung points out that consumer pressure is the main reason for reshoring, which is moving manufacturing back from a foreign country. But it is the security argument, especially that which pertains to medicine or Personal Protective Equipment (PPE) or food and energy supply, that is a ready justification.

What is deemed crucial to national security will likely be reshored, but the manufacturing of everything that falls outside of that description will become even more globalised than ever before, Dr. Fung believes.

“The Japanese were already talking about a China-plus-one policy, meaning you really want to hedge your bets and that you may not want to put all your eggs in one basket,” he explains. “So you want to go to double-source, triple-source to really get the resilience. For the part [of the business] that is still international and global, I actually see bigger globalisation in order to get the diversification.”

Dr. Fung also highlights the vulnerabilities that had built up in the quest to “squeeze that very last cent out of the supply chain” by making it hyper-efficient, but at the expense of resilience. Likening the supply chains to a stock portfolio with only two stocks, “I can do very well if they happen to do well…but when they external shock comes, I find it’s a problem”.

“What the world has now learnt is that you need a diversified portfolio,” he asserts. “Obviously you need to pay a small premium for the diversification. And there’s a tradeoff between efficiency and resilience in building supply chains. That, to me, is the major trend that is going to happen.”

WHAT NOW?

Looking ahead, Dr. Fung emphasised the importance of consumers in non-OECD countries, and especially those in Asia. With an additional two billion middle class consumers expected as early as 2040, the former Harvard University Professor of Finance is urging companies to ask themselves: “What do they want to buy? Can I just channel the same products from my global production platform? How do I access these customers?”

“You’ve got to then start asking what is the distribution [of customers in Asia],” he says while expressing a belief that Asia will not experience the kind of market consolidation seen in America where WalMart alone accounts for four percent of the market “and then everything else goes from there”.

“Hence, to reach the Asian consumer, you may need to deal with literally hundreds of thousands or even millions of small- and medium-sized enterprises. So it’s not a B2B type of situation, it’s B-to-small-B to consumer. You’ve got to think about new forms of distribution to reach those people, perhaps through technology.”

He concludes: “The impact that technology has is wreaking havoc on brick-and-mortar retailers around the world. And then you have the U.S.-China trade war, and now COVID-19. If you have any of one of those, it’s shock enough. If you have all three impacting the global economy and the global supply chains, I would have to say that is tantamount to a total reinvention.”

Dr. Victor Fung was the Leadership Perspectives speaker at the SMU Industry Leaders Virtual Dialogue held on 26 May 2020. He is the Group Chairman of Fung Group and Chair of SMU International Advisory Council (IAC) China.