The destructive Hurricane Sandy hit New York towards the end of 2012

HOW TODAY'S SUPPLY CHAIN CHALLENGES **WILL CHANGE THE FUTURE OF WORKING CAPITAL**

Plentiful goods, low-cost labour, solid supply. The status quo has been well and truly disrupted with implications for working capital. Brian Shanahan explores the issues

David Ricardo published the law of comparative advantage in 1817, stating that it was more advantageous for one country or territory to produce certain goods versus another. It was obvious that we should have trade in goods and services around the world today. The entity providing the goods or services logically should be located in one location that could best take advantage of its own circumstances to produce those goods and services at the lowest economic opportunity cost.

Well, that's the theory. But it hasn't worked out that way. In Ricardo's day, we had the Empire trading systems, so it was easier and cheaper to import fabric from India into England rather than source the same product from France or Germany. These systems stayed in place until 1945, when the General Agreement on Trade and Tariffs encouraged the nations of the world to trade fairly with each other. This did help to start customs unions in numerous parts of the world, but it wasn't until the fall of the Soviet Union and the opening of China that we saw world trade open up at a dizzying speed.

Now Ricardo's law really got traction. We are now at the point where most of the televisions in the world are made in a handful of places and a whole host of manufacturing activities have migrated to low-cost countries across the planet. China and India have huge advantages by having massive and low-cost labour pools, and that situation has allowed people in the rich countries of the West to enjoy

ALAMY

> In many parts of the world, our populations are on the verge of panic

all the latest consumer goods at a cost that is in real terms lower than 30 years ago.

DISRUPTION

Logically, this integrated global supply chain should continue to grow, but in the past five years we have seen that this very complex global supply network was far more fragile than we thought. There were early hints of the risks involved when disasters like the 2011 Fukushima Daiichi nuclear disaster caused a temporary world shortage of motor parts in the US, or when Hurricane Sandy disrupted international shipping for weeks after the storm had passed in 2012.

Very little action was taken by governments or corporations to mitigate any potential future risks of these kinds of disruptions. We carried on regardless to the point where many companies had lost visibility of their total supply chain. British prime minister Harold Macmillan was once asked what the most troubling problem of his premiership was and he replied: "Events, my dear boy, events."

Since 2016, we have had plenty of those. The great wave of globalisation seems to have been halted in its tracks by several events in different parts of the world that have resulted in an increasingly protectionist stance by many countries.

In Europe, the big issue was Brexit, which is still the largest peacetime change in trade rules that has increased trade barriers for centuries. Many European companies have had to change supply chains, on both sides of the channel, to cope with the new rules. Then we have the trade war between the US and China that started with President Trump but has not abated under President Biden. This has changed significant trade flows, particularly for agricultural produce across the world.

There have been additional pressures, including product boycotts in China of goods from certain nations due to perceived diplomatic slights. The Koreans and the Japanese fell out for a while due to some contentious statements from politicians. In the Persian Gulf, there has been a big drive for 'localisation' to ensure that each of the smaller Gulf states is more self-reliant. All these changes have resulted in various forms of supply disruption that have a material impact on how companies operate.

GEOPOLITICS

We spend 30 years building just-in-time supply chains that now don't work as well because of the various political tensions between the different trading states across the world. But worse was to come. In early 2020, we started hearing about a new virus that seemed to be running rampant in one province of China. Most expected that the worst that would happen would be that China would be out of action for few weeks and then things would return to normal. We had no idea that our entire world was about to turn upside down.

While the pandemic has taken a terrible toll on the world's population and is far from finished – depending on the exact part of planet Earth in which you reside – the supply chain effects have been monumental. Initially, it was that container shipping rates went through the roof as we found that many of the world's containers seemed to be in the wrong place. Since then, we have either experienced shortages or are expecting shortages in all sorts of goods ranging from liquid petroleum gas, semiconductors, toys, timber, cement and carbon dioxide.

In many parts of the world, our populations are on the verge of panic. This was seen in the form of bulk buying of toilet paper at the start of the pandemic, and more recently British motorists panic buying fuel. In both cases, there was no shortage of product, but consumers over-reacted when they felt the threat of a shortage.

And after all the trials and tribulations, what have we learned about our global supply chain? We learned what PPE was and the fact that almost everything was made in China.

> The ACT Working Capital Conference will be held in London on 8 December, co-chaired by Brian Shanahan. See treasurers.org/events/conferences/wcc-london21

We also learned that we had almost no contingency plan for when things went wrong.

We still have serious imbalances in the global supply chain that will probably take many more months to sort out. But are we ready for when some sort of supply chain shock will happen again? The early indications are that we will all be relieved when things return to some sort of normality and swiftly forget everything that has happened. The financial impact will be more imbalances in the supply chain, additional funding requirements for working capital and an increased capacity for companies to react fast to catastrophic events. When will all this happen? We don't know, but we know it will happen at some point.

The level of supply chain risk is not going away. If anything, it is increasing. This will likely mean that working capital will increase for many companies as the level of inventories increases to deal with supply chain gaps. For treasurers, this means more funding will be required and additional pressure on banking facilities.

WORLD EVENTS AND SUPPLY CHAIN SHOCKS

2011
The Fukushima Daiichi nuclear disaster, caused by the Great East Japan earthquake and tsunami

2012
Hurricane Sandy, the deadliest of the 2012 Atlantic hurricane season

2018
The imposition of tariffs on Chinese goods by the US

2019
The ongoing trade dispute between Japan and Korea

2020
The UK leaves the EU at the end of January 2020

2020
The onset of the COVID-19 global pandemic

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