Building resilience
A focus on supply chains

93%
of businesses plan to increase resilience across the supply chain
Source: McKinsey, August 2020

94%
of the Fortune 1000 companies experienced supply chain disruption from Covid-19
Source: Accenture, March 2020

53%
of global business leaders are moving to dual sourcing of raw materials
Source: McKinsey, August 2020

51%
of supply chain professionals expect their focus on the circular economy to increase
Source: Gartner, August 2020

The pandemic, rising geopolitical tensions and Brexit have created sustained pressure on supply chains. The ramifications have impacted all businesses and created a new imperative to act. We highlight the steps businesses should consider to identify and mitigate risks, and to build back better, more resilient and sustainable supply chains.

Building resilience: A focus on supply chains

Key highlights:

- The coronavirus has triggered the most significant global economic shock in modern history, impacting global supply chains.
- The mapping of supply chains will be crucial to building visibility, identifying and mitigating risks.
- Taking effective steps now will build resilience to future shocks and create a more sustainable supply chain.

The global economy is facing some extraordinary challenges as a result of the steps taken by countries across the world to contain the spread of the Covid-19 virus.

These steps have come with abrupt and severe social and economic consequences, including a devastating impact on international trade. In response, companies are reviewing their supply chains, often in greater detail than historically, and taking steps to reduce the impacts of disruptions from a second wave.

In this article, we discuss the key headwinds facing international trade and consider how businesses can prepare and build resilience into their supply chains.

Global supply chain pain

As we ended 2019, supply chains were typically highly efficient, increasingly driven by just-in-time principles to reduce inventory levels, enhance working capital, and drive financial performance.

In a highly competitive world market, retailers and manufacturers have chased lower cost supplies in order to preserve profit margins. This created international, often long, linear, and highly integrated supply chains, but companies typically lacked end-to-end visibility. Whilst this design worked well for decades, it was always susceptible to external risks such as natural disasters, geopolitical tensions, logistical failures and more recently the rising threat of cyber-attacks.

This finely tuned approach has been increasingly challenged by the US-China trade tensions, but the onset of the pandemic late in Q1 2020 had a far more profound impact on supply chains as governments across the world simultaneously acted to contain the emerging global health emergency.

> 41% of UK firms currently experiencing disruption expect supply chains to normalise within 6 months.[1]

Ed Thurman
Managing Director,
Head of Global Transaction Banking,
Lloyds Bank Commercial Banking

1 Lloyds Bank Business Barometer, September 2020

The World Trade Organisation estimated the total impact on trade could amount to a 32% reduction in 2020.[1]

Key supply chain risks into 2021

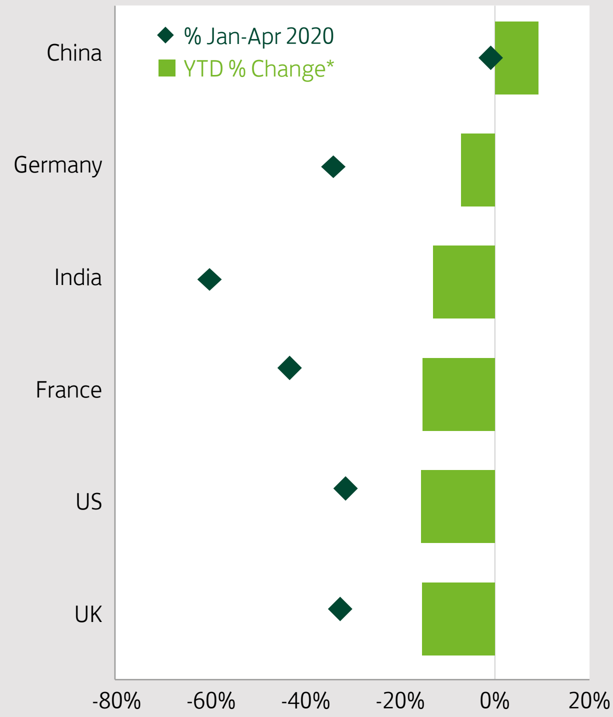
The pandemic represents the dominant influence on the global outlook. The extent to which it will leave scarring on global trade and individual economies is unclear. Governments have, alongside central banks, injected huge amounts of stimulus to support businesses and households. At the current junture, there is still an exceptionally high degree of uncertainty concerning both the future path and legacy of the crisis.

International trade has increased significantly, alongside the broader economic recovery from national lockdowns. For many economies, exports have recovered more than half of their earlier decline in the first four months of the year. China, which both entered and exited lockdown first, has returned to year-on-year growth. Looking ahead, the short and long run implications for international trade will remain closely entwined with prospects for the global economy.

The initial epicentre of the pandemic – China's Hubei province – acutely evidenced China's status as the world's manufacturing hub as their production shutdowns rapidly impacted companies across multiple sectors. Recent research reveals more than 50,000 companies had tier 1 suppliers in China[2] and 90% of fortune 1000 companies had tier 2 suppliers in the most impacted regions of China[3] leading to severe disruption once lockdowns were imposed.

Global trade contracted by 4% in Q1 2020, for only the second time since the mid 1980s. As lockdowns extended across the globe, the World Trade Organisation estimated in June, that the total impact on global trade could amount to a 32% reduction in 2020.[1]

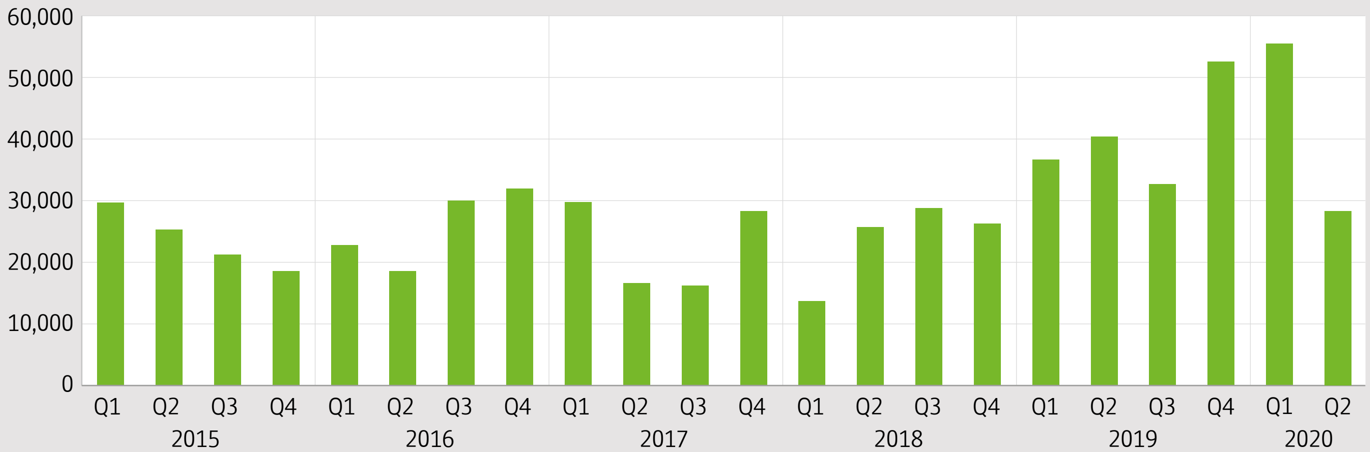
Impact of Covid-19 on goods exports



Source: OECD, MEI (Main Economic Indicators)
* YTD is January to latest figures available: China and India: August. UK, US, Germany and France: July.

1 WTO press release 22 June 2020 pessimistic scenario
2 McKinsey, August 2020
3 Dun & Bradstreet 2020

World Economic Policy Uncertainty Index



Source: IMF World Economic Policy Uncertainty Index (GDP weighted average)

Looking beyond the pandemic

In spite of the signing of the Phase 1 US-China trade deal in January 2020, tensions between the two largest economies continue to be a harmful headwind for the global economy. The IMF World Uncertainty Index, that captures economic and political uncertainties, hit new highs in Q4 2019 as deteriorating relations resulted in bilateral tariffs between the US and China before rising further in Q1 2020 as the pandemic struck.

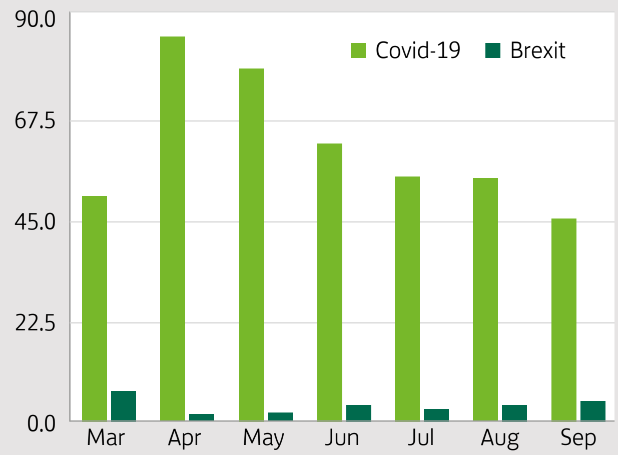
The result of the forthcoming US election may represent an important milestone. Regardless of the result, the market anticipates continued tariffs and fragile trade negotiations. However, a change in President may temper the fractious rhetoric. Democratic presidential nominee, Joe Biden, has spoken about rebuilding US alliances globally and strengthening US supply chains. While he has pledged to reduce dependence on China, he is promoting the idea that "economic security is equivalent to national security".

The rise in US protectionist policies globally certainly impacts the UK. In addition, the UK faces the prospect of the end of the Brexit transition period on December 31st 2020, signifying the end of the UK's current trading arrangements with both the EU and some global trading partners. Concerns over the likelihood of leaving the EU without a deal have risen in recent months.

Despite the impact of Brexit, the EU will continue to be a key trading partner and international ally for the UK. The UK currently has a surplus in services trade with the EU, but this is dwarfed by its deficit in goods trade where the value of imports from the EU far exceed exports into the EU.

Despite the uncertainty over the future relationship between the two sides, it is widely agreed that the risks to the UK economy, of leaving the EU and ending the transition without a deal, are skewed downwards in the long term. Results from The Decision Makers Panel survey, conducted by the Bank of England, suggests that businesses are more optimistic, the average probability of no material impact on sales has remained relatively stable over the last year, recording 54% in August. The proportion of firms reporting Brexit as their main source of uncertainty has fallen to 3% in August but has now begun to rise again to 4% in September compared to 45% listing Covid-19 uncertainty as their main concern.

UK Firms – Largest source of uncertainty



Source: Bank of England Decision Makers Panel survey

How should businesses react?

Even before the emergence of the pandemic, businesses were looking for ways to make supply chains more resilient. Progress has been relatively slow until now, but the imperative to act combined with developments in technology suggest more material progress ahead.

While there is no silver bullet solution, there are multiple, incremental changes that can deliver an improvement in the risk profile of any company's supply chain. The design of any solution must reflect the impact on costs and the consumption of working capital as well as the benefits of risks which are now avoided as a result of the solution.

A detailed mapping exercise of supply chains is a key requirement for all.

Key considerations will be:

1 Supply chain visibility and risk management

One fundamental change needed is to create genuine, in-depth visibility of supply chains.

Historically, the detailed mapping of supply chains has been a challenge, especially below tier 1 suppliers. The emergence of digital solutions provides enhanced intelligence and early warning indicators across a diverse range of risks.

Platforms are now available, that through the use of advanced analytics help to improve supply chain integrity and rank and triage the most critical risks.

Too many businesses were unaware of their dependency on factories in Hubei province, even for critical components, until goods failed to arrive after the lockdowns in China. Knowledge is a key and vital enabler, and understanding the risks and the appropriate mitigants within a supply chain can empower both a fast response to threat and more importantly, provide early identification of potential issues .

One tool for mapping and diversification was produced by the Asian Development Bank (ADB). The ADB created a series of interactive maps to provide the detailed intelligence needed to provide visibility for companies involved in the manufacture and distribution of goods critical to fighting Covid-19. The supply chains for ventilators, masks and other key products were dissected down to each component part, globally. Likewise, the tool provided detail on buyers of PPE components and finished goods, including those in the UK.

Not only did this demonstrate the art of the possible, but it's criticality to ongoing global efforts to tackle the pandemic cannot be underestimated.

Larger companies may also consider steps towards vertical integration to ensure the availability of critical components. Acquiring a supplier can ensure greater levels of control. The recent pandemic, and the lockdown of whole countries and regions potentially nullified some of the benefits of ownership, but such integration would provide maximum visibility and decision-making capabilities to drive the return to production.

2 Supply chain diversification

Supply chain visibility provides the foundation for diversification. For example, if a mapping exercise reveals single source dependencies for critical goods, alternative suppliers can be sourced, or inventory levels increased in order to further build resilience.

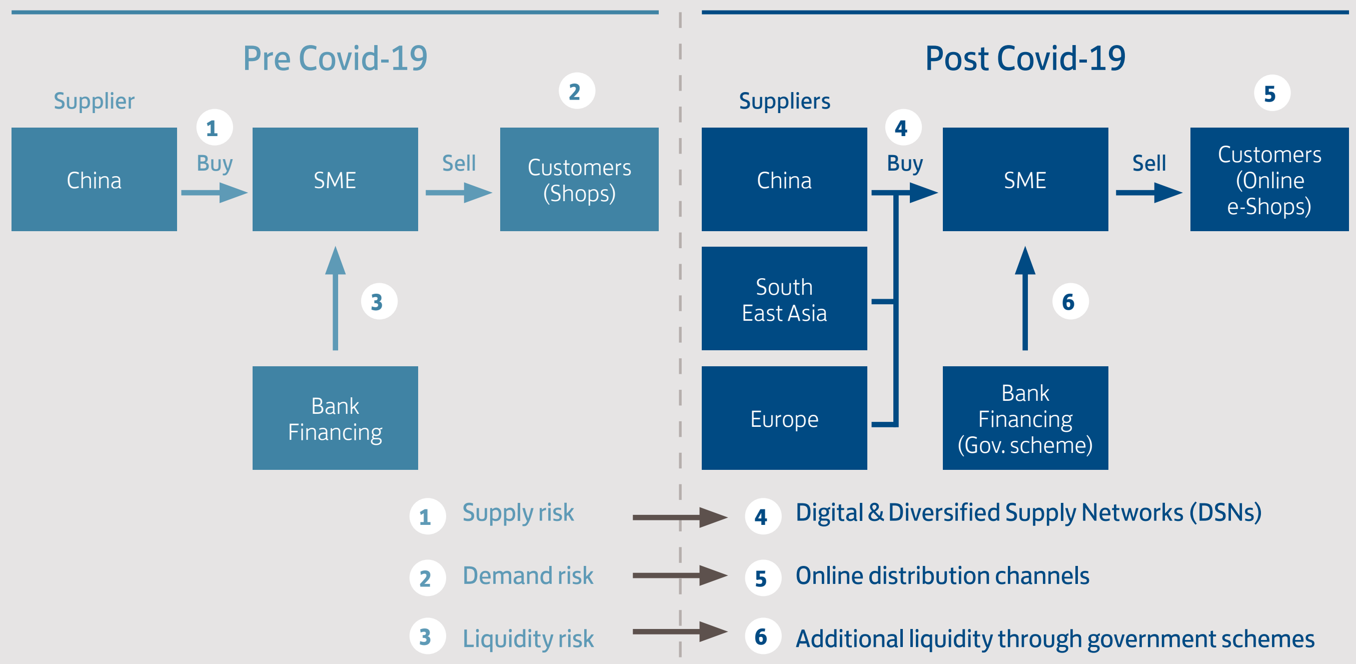
Supplier diversification may need to encompass multiple geographies in order to build genuine resilience. This approach not only improves security of delivery but can also address the need to increase supply quickly – whether required for an inventory build or a rapid response to unexpected increase in demand. Key sectors including chemicals, healthcare and food and drink experienced demand spikes as the pandemic spread. Having these options in place can provide a more cost-effective means to restore or augment production/supply in times of crisis, avoiding the need for rushed decisions that may impact on quality, cost and reputation.

3 Alternative, additional suppliers closer to home, reducing distance

The impact of the pandemic has challenged the economics of manufacturing or sourcing raw materials and finished goods over significant distances. Lower costs may become less attractive if they come with a higher risk of supply chain disruption.

This has also led to calls for near or re-shoring of production alongside building proximity into supply chain models to reduce dependencies on particular markets especially those more distant from the point of production and/or sale.

Supply chain diversification



> 47% of firms have expressed the intent to increase inventory for critical products.
>
> **Gwynne Master**
> Managing Director,
> Head of Trade, Global Transaction Banking,
> Lloyds Bank Commercial Banking

Selecting the right location for production may increase the surety of input materials or finished goods, but the pandemic's wide-reaching impact on the global economy also critically reduced the ability to transport goods to where they were needed. As goods remained in situ, warehouse capacity was reduced and the whole system slowed as bottle-necks developed and impacted delivery.

Transport difficulties can be mitigated by reducing the distance over which materials must travel. In addition, developing transport options moving from smaller capacity air to larger scale sea cargo solutions may offer a more resilient solution.

The increasing tensions between the US and China, and indeed the UK and China, in regard to the future of Hong Kong add new dimensions to the selection of Chinese suppliers and suggest the need to find alternative, or perhaps closer to home, sources of supply.

Alternatively, the likelihood of any new trading relationship with the EU creates interest in lengthening supply chains to cheaper producers to mitigate the potential impacts of tariffs being applied to EU derived imports.

4 Address inventory and forecast demand

Supply chain models have, in many cases, operated on a "just in time" inventory strategy to limit idle stock and optimise working capital. An initial response to recent supply disruptions has been a switch to a "just in case" approach, where higher inventory levels are held to ensure supplies are on hand and activity can continue if a leg of a given supply chain is interrupted.

Any increase in inventory comes at a cost and will inflate the amount of working capital needed within the cycle. A blended response may be to increase inventory for key inputs – 47% of firms express the intent to increase inventory of critical products[1] – that support activities which drive the best returns, potentially withdrawing less profitable product lines to off-set costs and free up logistical capacity.

On the demand side, the impact of the pandemic has made demand and production planning far more challenging. Demand has been negatively affected across all sectors with some, such as hospitality and construction, experiencing greater impact than others. An unprecedented fall of this level means it is critical that businesses evaluate inventory levels in the light of the best available demand forecasts and seek to optimise their ability.

> 40% of supply chain leaders stated they were looking at near-shoring and expanding their supplier base.[1]

1 McKinsey, August 2020

An opportunity to build back better

The review and re-design of supply chains provides an opportunity to ensure a resilient and more sustainable future.

Incorporating Environmental, Social & Governance (ESG) principals can deliver improved resilience in a wider sense. The range of current challenges and the accelerated deployment of innovation can only assist.

Environmental

As businesses review and reimagine their supply chains and consider new suppliers from new locations, this creates the opportunity to "build back better" and address sustainable supplies as climate change is, and will continue to be, a global imperative which requires a response.

Whilst the impact of the global pandemic may have forced businesses to focus on short term fixes to enable them to survive, a more strategic and genuinely sustainable approach is needed if they want to thrive. Recent research suggest that 51% of supply chain professionals[1] expect that the focus on circular economy strategies that support the recycling and reuse of materials will increase over the next two years.

Switching to environmentally sound suppliers may be the big reset needed to override the highly focussed pursuit of efficiency that has led to reduced resilience and challenged long term sustainability.

Social

It is important to reflect that changes made at the top of the supply chain will have an impact on others within the supply chain. We see significant focus on the largest suppliers, while the smallest may be as or more critical and potentially the most vulnerable.

Large corporates may be able to initiate supply chain finance (SCF) programmes to ensure the speed and reliability of payments to their suppliers, thereby building resilience to any financial shocks. Smaller businesses can benefit from participation in SCF programmes, benefiting from certainty and speed of payment for completed work.

There is a strong link between the recent increase in early payments and supply chain resilience. In a recent survey 56% of small businesses[2] were operating with cash reserves of only 27 days. With this as a backdrop, the benefits of early payment are clear and offer a route through which the end-to-end supply chain can be made more secure throughout.

Governance

As companies aim to "build back better" it is important to ensure that the refreshed supply chain is not only visible and environmentally sustainable, but also ethical.

Both consumers and procurement teams alike are increasingly focussed on the ESG credentials of business from which they chose to buy. As end-to-end supply chain visibility becomes more possible and technology can be used to further augment clarity, ESG is becoming a critical factor in selecting suppliers to ensure a more resilient and sustainable business.

The Covid-19 crisis underscored the importance of the scope and approach to supply chain strategy and design. Supply chain risk, already heightened by an increased incidence of material weather events and geopolitical tensions, puts ESG on centre stage.

Even if economic and practical necessity demands that a supply chain remains unaltered, a new approach to the monitoring, identification, and management of all risks is needed to provide early warning against future challenges.

> 51% of supply chain professionals expect that the focus on circular economy strategies will increase.

Gwynne Master
Managing Director,
Head of Trade, Global Transaction Banking,
Lloyds Bank Commercial Banking

1 Gartner, August 2020

2 JP Morgan 2020

Case studies

Toiletry Sales Ltd ("TSL")

Toiletry Sales Ltd ("TSL") are a well established supplier of medical and associated products to major retailers and discounters in the UK. As with many businesses supplying the retail sector, TSL have been impacted by the pandemic, experiencing a risk to the core business.

Amid the Covid-19 outbreak, the business has been exploring how they could diversify their existing product range and introduce PPE and face masks in order to supply major retailers and the NHS. TSL utilised its position as a long-term customer to certified Chinese suppliers (using their own Chinese technical team) to secure face mask supply.

As a trusted supplier to major retailers and the NHS, TSL were able to quickly adapt and secure certified sales and supply in a rapidly changing market place.

Due to the global demand for PPE and face masks, TSL were faced with a change of suppliers, which put short term pressure on the TSL cashflow.

A solution was quickly agreed with Lloyds Bank, which enabled TSL to fund its face mask business, secure additional sales and meet customer expectations. In addition, as the demand for face masks is continuing in the longer term, Lloyds Bank is providing an asset finance facility to enable TSL to purchase two machines. This allows face masks to be manufactured in the UK and reduces TSL's exposure to volatile airfreight costs for importing completed masks from China and to review where their raw materials are sourced from.

This will enable UK customers to purchase face masks at a competitive price without having to hold large amounts of stock, reducing the risk of any future price increases or supply issues from China.

Clothing and sportswear – moving online

One of our clients runs a clothing and sportswear business. Before Covid-19, their main supplies were sourced from China as prices were competitive. As factories shut down production in China as a result of the Covid-19 lockdown, orders were re-directed to an alternative supplier base in other South East Asian countries and Europe.

Lloyds Bank was able to increase their Letter of Credit limits to cover the costs of newly sourced merchandise as the alternative sources came at an increased cost.

As the pandemic spread globally, and the UK announced their own lockdown, Covid-19 cut off the distribution channel for the company which primarily used physical shops for sales. The company pivoted to the use of online channels to maintain sales and cashflow generation. The Lloyds Bank facility was complimented with Government schemes and loan extensions to address liquidity shortages for the company.

This additional funding supported the business as it switched channels and enhanced its online revenues.

Conclusion

The pandemic has highlighted significant vulnerabilities in global supply chains. The scale and duration of the economic shock, perhaps not yet over, has been the most significant seen since the 1940s.

In addition, the challenges driven by geopolitical tensions and the impact of Brexit add further pressure on supply chains. The range and scale of these combined challenges create an imperative for businesses to identify and mitigate risks.

Pressure on cash flow will increase in the coming months as working capital requirements grow in line with increased trading. Risk within the supply change will also increase as businesses manage themselves through the uncertain trading environment.

Whilst trading negotiations with the EU continue, there is a risk that further costs and burdens will be placed on businesses if frictionless trade comes to an end. Managing the potential cash flow implications could drive further cash and working capital challenges. All changes to supply chains must be assessed through the lenses of working capital and risk.

It will be important to remember that Brexit will impact EU firms as well as UK firms. We are hearing that the willingness of EU-based businesses to trade with UK firms has reduced.

As the UK navigates what may be an undertain period, Lloyds Bank will continue to support UK businesses to improve the management of both working capital and the risks associated with international trade.

We have set out some key actions that you can take within your business to improve supply chain resilience:

- Improve the visibility of your supply chain as a foundation for on-going risk assessment and understanding.
- Carry out an end-to-end risk assessment to identify and triage risks and design mitigations.
- Optimise inventory to insulate the business from potential shocks in the short term and maintain production, sales activity, and revenue generation.
- Look to diversify suppliers and build resilience in a planful and measured way.
- Develop a clear ESG strategy to ensure that supply chain enhancements deliver across all aspects of the resilience agenda.

Our Trade solutions

Lloyds Bank can help you manage both risk and address working capital requirements within your supply chains. Our Trade solutions can help you to access funding and mitigate against the risks of non-payment or non-receipt of goods.

Options include:

- **Documentary Collections** – A cost-effective way to mitigate payment risks across your supply chain.
- **Letters of Credit** – Giving you confidence that goods have been delivered and produced to the specifications ordered before you are liable for payment.
- **Bonds and Guarantees** – Sometimes required to bid for overseas business and can demonstrate improved credit-worthiness.
- **Trade Loans** – Short-term tailored funding solutions to optimise working capital to finance your purchase/production/sale of goods at a time when you most need it. Fills the financing gap – If you need to fulfil a sales contract but need funds to purchase raw materials or process goods for export or when you have shipped goods to a customer, Lloyds Bank may be able to advance payment, giving access to working capital to fund further operations.

Lloyds Bank can also support more complex funding needs through solutions including:

- **Supply Chain Finance**
- **Receivable Purchase**

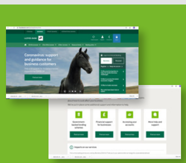
And supports the:

- **UK Export Finance ("UKEF") Working Capital Scheme** – a UK Government initiative with the mission to ensure that no viable UK export fails for lack of finance or insurance. In partnership, Lloyds Bank can work with Exporters to gain access to working capital finance, helping Exporters to win and fulfil contracts by providing attractive financing terms to their buyers, supported by working capital loans.

For more information, please click here.

International Trade Portal

Provides analysis of supply chains, ensuring you're well informed to source new partners.



UK Recovery Tracker

Assessing how the UK economy is faring in a global context, considering the sustainability of the recovery.

Our service promise

If you experience a problem, we will always try to resolve it as quickly as possible. Please bring it to the attention of any member of staff. Our complaints procedures for businesses with an annual turnover of up to £25m are published at **lloydsbank.com/business/contactus** and for businesses with an annual turnover of £25m or more they can found at **commercialbanking.lloydsbanking.com/contact-us/**

Go to:
lloydsbank.com/help-guidance/coronavirus

If you would like to know more, please speak to your Relationship Manager

Please contact us if you would like this information in an alternative format such as Braille, large print or audio.

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