Growth amid uncertainty–setting your international course using the right stars

How can businesses better strike a balance between growth and efficiency?

In this era of enduring trade shocks and uncertainty, businesses are grappling with the decision of whether to prioritise growth or resilience when setting up international operations. Covid-19 and the US–China trade dispute have brought supply chain issues to the fore. These concerns look unlikely to dissipate, with a 2021 survey highlighting the top concerns for businesses over the next two years as the US–China trade dispute, followed by rising inflation due to the pandemic and future covid-19 variants. Now with the onset of the Ukraine war, supply chain issues have risen even further up the business agenda.[1] There are many "stars" businesses can use to navigate these shocks and uncertainties. Choosing the right ones will help to strike the right balance between growth and resilience.

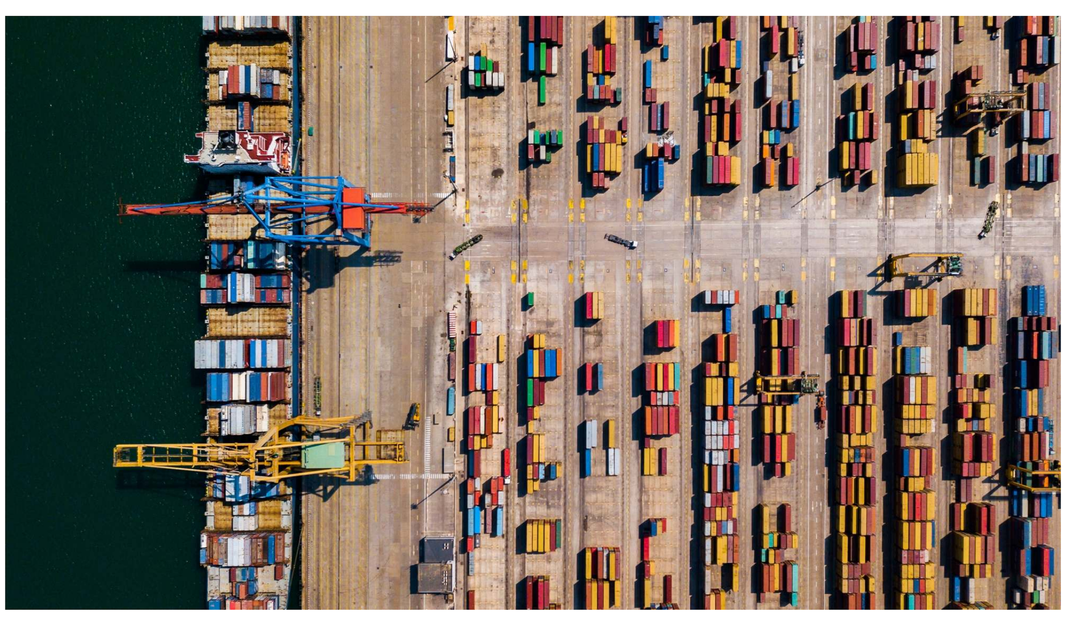
Efficiency vs resilience

Before covid-19 businesses were prioritising efficiency due to the increasing interconnectedness of global markets. The "just-in-time" supply chain practice has increased business productivity through participation in global value chains (GVCs). Such participation allows companies to specialise and reap rewards, through growth and productivity, from their individual comparative advantage. However, with the onset of the aforementioned trade shocks, some are asking whether there needs to be more resilience to adapt to these disruptive changes. Many more are already altering business strategies to prioritise resilience in the current business climate.

Vineet Khanna, Senior Vice President and Global Head of Supply Chain at Nestlé, claims that "traditionally, strategies have had a bias for cost efficiency and capital efficiency". He goes on to say that in today's climate with more risks emerging, business strategies also need to include "agility, sustainability and resilience". However, he cautions that businesses should avoid huge pendulum swings in the name of resilience. Reshoring manufacturing or chartering your own cargo ships, which many companies are doing, may secure supply chains in the short term but, in "two to three years' time, businesses may find themselves too asset-heavy with not enough flexibility in their supply chain".

This begs the question: if a company swings too far in favour of resilience, will this reduce its growth opportunities? Money that is tied up in increased stock or invested more heavily in owning transport links cannot be used profitably elsewhere. This also increases the volatility of corporate earnings.

Decisions regarding resilience may have been made in the silo of the constant trade shocks of covid-19, the US–China trade dispute and the Ukraine war. Once GVCs have adapted to these, it may be that such decisions made during these shocks actually impede a company from growing globally. We may already be seeing the consequences of such decisions as the share price of companies such as Walmart and Target fell sharply in mid-May 2022 when they revealed they had been left with large stocks of unsold goods.[2]



Trade policy tools

Data and technology

One way that companies can reduce the risk of the silo effect is to rely on data and technology.

Previous improvements in technology mean that firms have more detailed and timelier information about consumer demand. This has facilitated the just-in-time business model, as technological changes have made large precautionary stockholdings redundant. Mr Khanna believes that one of the central ways businesses can improve their business models is through the adoption of further technological advances such as digital control towers or advanced automation.

Using advances in technology and data-driven insights can modernise supply chains and make them more resilient. While 63% of the world's population is now online,[3] Economist Impact found that, on average, only 36% of companies had adopted some form of advanced technology, such as 5G, artificial intelligence or blockchain technology, prior to 2021, leaving much more room for progress. If implemented well, digitisation can improve a company's economic and financial performance, with one study finding that **digital supply chains can reduce supply chain costs by 50% and increase revenue by 10%.**[4]

Diversification of supply chains

Another key way to enhance business resilience is increased diversification, which Economist Impact found 48% of businesses are already doing. Reducing single-sourcing helps to build flexibility which can be leveraged to effectively counter future events or risks. IMF data confirms this as its analysis finds that diversification can insulate companies against economic losses as a result of supply chain disruptions. Firms in the Western hemisphere currently source 82% of their inputs domestically.[5] Therefore, there is a lot more scope for firms to diversify globally.

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Diversification can also come in the form of substitutability. This can come from greater flexibility in production or by standardising inputs. Both allow for a greater number of inputs to become available, reducing the threat of a supply shortage for businesses.

ESG initiatives

Tapping into ESG (environmental, social and governance) initiatives is another way in which companies balance the tensions between growth and resilience. Adopting a mature approach to ESG can help ensure business continuity in the event of disasters. Taking a holistic view of ESG, by minimising the use of resources such as water and energy, for example, can help mitigate the impacts of severe weather events and rising energy prices, while reducing business costs. The harmonisation of cost reduction and improving environmental credentials can also come from other initiatives such as minimising waste. Such ESG policies also have a knock-on effect through driving consumer preference, as customers are willing to pay more for "green" goods and services.

Tapping into trade policy tools

While effective, the above strategies can come with compliance challenges. But recent years have seen a rise in the number of trade agreements which include provisions for, among other areas, market access, digital trade, and environmental and labour standards. These help increase compliance between markets so businesses can better utilise the benefits offered. When asked how businesses can expand, Dr Deborah Elms, Founder and Executive Director of the Asian Trade Centre, stated that "using some of the newer trade agreements that give benefits to member firms that non-member firms do not receive can provide advantages."

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Examples of these newer trade agreements include the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Regional Comprehensive Economic Partnership (RCEP) and various digital trade agreements. There are tangible benefits associated with these new trade tools as they prioritise more liberal market access, the openness and free flow of data and ESG opportunities, among many other benefits, all of which provide significant value to companies.

Even as countries move politically and ideologically further apart, trade agreements can ensure that economic ties between them remain strong. Strengthening economic ties can ensure that the right stars are available for businesses looking to navigate the increasingly uncertain global trading system. Businesses need to incorporate the use of these trade agreements into their business planning due to the significant benefits they provide and because of the stability and consistency they offer.

References

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