



# The changing face of global procurement

## How to build resilience in international supply chains and reap maximum benefits

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**Over the last few decades, supply chains in most industries have become increasingly globalised – and with good reason.**

Globalisation offers many benefits, including:

- Access to alternative or specialist suppliers
- Tapping global talent pools and highly educated international workforces
- Best-value country sourcing for manufacturing and talent
- The ability to service or adapt to the needs of local markets more effectively
- Advancing corporate social responsibility agendas by contributing to the economic health of other, developing countries

But, in more recent times, this trend has come into question as global supply chains have proved to be less resilient, more complex, and more vulnerable to events than previously thought.

The COVID-19 pandemic is the most visible example, with the effects continuing to play out in terms of disrupted shipping flows, reduction in output from manufacturing plants, and ballooning freight costs. The Suez Canal blockage is another, creating massive disruptions in global trade and major downstream problems. Insurer Allianz estimated the cost to global trade at between \$6 – \$10 billion per week.

Supply chains are also increasingly targets of cybersecurity attacks, and these attacks are increasingly expensive. The average cost of a data breach is around \$US 4.4 million (according to the latest IBM / Ponemon Institute 'Cost of a Data Breach' report) – and the reputational costs can be much greater. Meanwhile, the incidence of these attacks is growing exponentially. The European Union Agency for Cybersecurity (Enisa) predicted there would be four times as many in 2021 compared to the previous 12 months.

But while there's no disputing the impact of these types of events, they are symptoms of a wider issue.

While globalising your supply chain may make economic sense, it also creates more complexity. Ensuring the same levels of quality, service and security from a global supply chain requires more management, more communication, and more processes in place – all of which are too often overlooked.

Added complexity and geographical separation also means less control and increased vulnerability. Recent events have shone a spotlight on these risks and prompted governments and businesses to take a fresh look at how to build greater resilience in critical supply chains.

At the same time, some of the fundamentals behind the globalisation of supply chains are also coming under scrutiny. For example, the case for global supply chains as a 'low-cost sourcing' model is being challenged by rapid growth in global wages and shipping costs. According to the Xeneta Shipping Index, long-term ocean freight rates in September 2021 had almost doubled year on year (up 91.5%).

Meanwhile, the ILO Global Wage Report showed real wage growth across the world rose between 1.6% and 2.2% in the four years preceding the COVID-19 pandemic, with growth in Asia-Pacific and Eastern Europe outstripping the rest of Europe and North America.

To illustrate the changing face of global procurement, we take a closer look at the factors impacting supply chains in two key sectors. We also look at how organisations can respond to these challenges and gain competitive advantage in a turbulent and unpredictable global environment.

## When the chips are down: The global semiconductor shortage

Anyone trying to buy a new car, a new smartphone, a new gaming console, or even a new appliance will likely be all too aware that there is a major global shortage of semiconductor chips.

That's significant, because these chips are critical components in millions of products – from the electronic devices we now take for granted to advanced medical equipment, and more. As a result, manufacturers of those products have been forced to curb production and consumers have been unable to purchase them. The shortage is expected to take months or years to correct and has been described by some governments as a national security issue.

There are a range of reasons behind this, including:

- **A major surge in demand** during the pandemic as lockdowns forced people to work at home and saw greater use of electronic devices
- **Geopolitical tensions** – for example, sanctions placed by the US government on sales of chips to China's largest smartphone manufacturer, and by China's largest semiconductor manufacturer
- **Lack of suppliers** – a small number of large manufacturers, centred in one region (Asia), dominate the market. For example, Taiwan accounts for over 60% of total global semiconductor foundry revenue, with most of that accounted for by one company (Taiwan Semiconductor Manufacturing Co)
- **Demand planning issues** – for example, after reducing orders for chips following a slowdown in sales in 2020, the car industry was caught short by a rapid rebound
- **Long lead times** – establishing new production facilities is capital intensive

and complex, so ramping up for increased demand takes time

- **Reduced production** because of natural disasters, such as fires and storms, at key facilities, along with the impact of the COVID-19 pandemic

Governments have responded to the crisis by investing in building local chip-making capabilities and supply chains. Earlier this year US President Joe Biden announced his proposal to spend \$50 billion on semiconductor manufacturing and research. China, South Korea, and the European Union have all made multi-billion-dollar commitments to expanding local production.

However, the cost and complexity including the need to find and train a highly skilled workforce – means it will take some time for this re-shoring to come on stream. In the meantime, demand will continue to increase.

Many of the issues behind the shortage are a result of the increased risks arising from the globalisation of the industry's supply chain – and there are no simple answers.

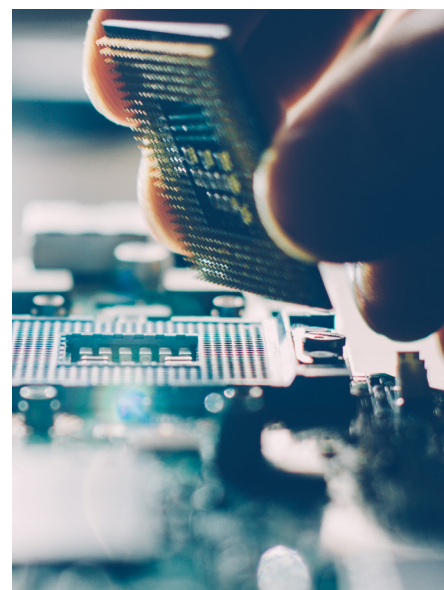
## A hard pill to swallow: Pharmaceutical supply chains

A visit to the doctor can be stressful – especially when the medicines they prescribe may not be available. Access to common antibiotics and basic medicines for blood pressure, pain management, and the like is increasingly under pressure. In the US, the American Medical Association has described drug shortages as an urgent public health crisis.

Globalisation of the pharmaceutical supply chain has developed significantly over the last two decades. One outcome of this is that today, around 80% of active pharmaceutical ingredients (APIs) and key starting materials come from China and India (and a handful of other countries). India also produces a significant percentage of generic drugs globally.

This over-dependence on a small number of sources greatly increases the risk of disruption to supply chains, making them disproportionately vulnerable to factors such as geopolitical tensions, disruption to distribution systems, natural disasters, public health crises, and more. For example, early in the COVID-19 pandemic, India restricted the export of a range of drugs and active ingredients to ensure adequate domestic supplies.

It's also more difficult to ensure quality



levels in drugs manufactured a long way from home – and getting it wrong can have serious consequences. Other issues that pharmaceutical companies need to consider from a global supply chain perspective include the emergence of new, next-generation drugs, often with more demanding requirements for storage and shipping, and rising demand in many regions.

As with semiconductor chips, one response has been to re-shore manufacturing and build larger stockpiles of key medicines to reduce exposure to these types of risks. However, while we're likely to see more reshoring and stockpiling, global supply chains will continue to be a feature of the industry. A more sophisticated approach is required.

## Building resilience: Reimagining global supply chains

These examples illustrate some of the challenges organisations are grappling with when it comes to managing global supply chains – and the effects are being felt across all sectors.

Respondents to the Center for Advanced Procurement Strategy (CAPS) Supply Chain Resiliency 2021 survey reported a 300% increase in supplier-related disruptions since the COVID-19 pandemic began. That's echoed in the Achilles Supply Chain Resiliency Index (ASCRI), which shows supply chain resilience falling consistently over the year and is now in the 'High Risk' range.

But while this data reflects real issues, the future is unlikely to see a wholesale shift from

globalised markets to local or regional ones. Instead, we can expect to see a more balanced approach, as countries and companies seek better management of risk and greater resilience in essential supply chains. One result of the issues being experienced in the wake of the pandemic will be governments encouraging investment in local capabilities in key segments, to build greater self-reliance, and reduce dependence on overseas suppliers. We're also likely to see a move away from just-in-time inventory management towards holding higher levels of buffer stock.

However, there are very strong reasons why globalisation will continue to be important. Best-value sourcing, access to alternative suppliers and different skills and expertise, and the ability to serve local markets are all compelling benefits. However, the environment is changing, and businesses will need take a more targeted and strategic approach. That includes assessing the trade-offs between cost, working capital, and service levels when it comes to their supply chains. A hybrid model that recognises there are likely to be specific areas where local knowledge and capability are strategically important, while other areas can continue to benefit from a global approach, is likely to be more effective ongoing.

But while global supply chains are not going away, nor are the challenges of globalisation. For those companies who can successfully address those challenges, there is an opportunity to gain significant competitive advantage.

In our experience, of the organisations that have weathered recent disruptions like COVID-19, Brexit, the Suez Canal crisis, and others, the most successful are those that have invested in building their supply chain management capabilities. As a result, they have been able to adapt and respond to these challenges proactively, rather than reactively.

In particular, to meet the challenges of the new and more volatile global environment, procurement organisations will need to focus on building greater resilience into their supply

chain. Key to this is developing an effective framework to identify, mitigate and manage risks at supplier, contract, and category/market levels.

To do this, developing much greater visibility and transparency throughout your supply chain is vital. Many organisations, for example, have very limited visibility beyond their Tier 1 suppliers. This increases exposure and makes it difficult to proactively identify areas of risk and develop effective risk management plans. It also makes it difficult to assess how well those Tier 1 suppliers are managing their own supply chain risks.

Other important factors organisations will need to focus on to develop greater resilience include:

- **Developing a deeper understanding of the supplier market**, allowing them to identify and develop alternative suppliers, and reduce exposure to a small number of suppliers or locations.
- **Moving from a transactional to a much more collaborative relationship with suppliers** – this includes developing an intimate understanding of their capabilities, competitive environment, and risks, so you can work with them proactively to jointly address challenges or take advantage of opportunities. In times of crisis, suppliers are much more likely to give preference to buyers with whom they have an established, mutually beneficial relationship.
- **Building stronger collaboration with business units** to help understand what customers value, key financial pressures and risks, and better understand demand patterns and shifts.
- **Positioning procurement and supply chain issues higher on the strategic agenda** of the business, as they are increasingly key in an ever more inter-connected world. The growing focus of Environmental, Social, and Governance (ESG) factors at the boardroom and executive level has provided an opportunity, given the key role procurement plays in achieving ESG goals. The current global supply chain 'crisis' provides another platform to raise the profile of the procurement function.

## With change comes opportunity

In our current environment, procurement professionals have an opportunity to drive significant change in the way global supply chains are managed – and deliver real strategic advantage in the process.

Please visit our [Logistic & Supply Chain Optimisation](#) page for information on how we can assist your business.



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