



Retailers Feel Impact of Coronavirus on Non-US Suppliers

Disruption in the Retail Supply Chain Reveals the Need for Contingency Planning

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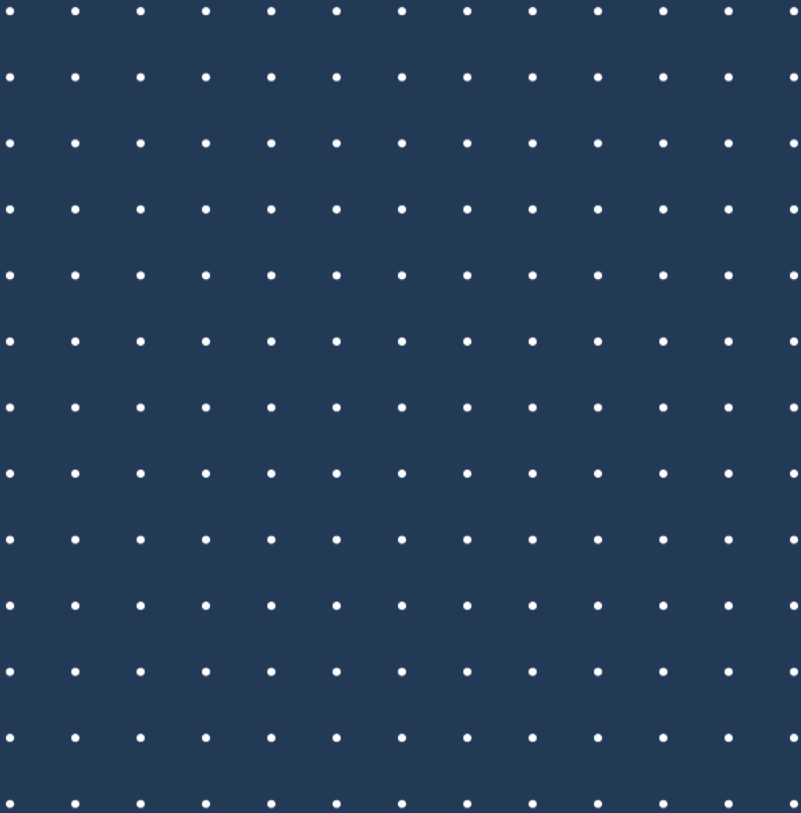
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INTELLIGENCE THAT WORKS





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An aerial photograph of a city street, likely in an urban area, showing buildings, roads, and parking lots. A light blue rectangular text box is overlaid on the left side of the image, containing a paragraph of text. The text discusses the spread of the coronavirus (COVID-19) and its impact on the world, comparing it to the 1918 flu pandemic. It mentions that the primary concern is for the global community and the potential impact on people's health. It also states that for retailers, this event provides a stark reminder that global supply chains can be disrupted quickly and with dramatic effect.

The spread of the coronavirus (COVID-19) has the world on edge, hoping that world health officials can implement measures to limit the continued spread outside of China and prevent a repeat of the global impact seen in the 1918 flu pandemic that left approximately fifty million people dead worldwide. The primary concern is for the global community and the potential impact on people's health. That said, for retailers, this black swan event provides a stark reminder that global supply chains can be disrupted quickly and with dramatic effect.

The Impact of a Black Swan Event

The first reported case of the coronavirus was in late 2019 in Wuhan, China. It was reported to the World Health Organization (WHO) as an unknown virus, but less than two weeks into 2020 the virus had a name and claimed its first fatality. By late January, the WHO declared the coronavirus to be a global emergency with over 7,700 cases and 170 deaths in China. We now face a serious health crisis worldwide.

Impact on Global Work Force

As of February 18, more than 780 million people in China were under some type of travel restriction. As factories and offices open, workers are either unable or unwilling to come back to work. These reductions in available labor directly impact production and transportation capacities within China. Additionally, transportation into and out of China has been constrained. As the coronavirus reaches other regions, its impact will broaden in scope and depth.

PRODUCTION IMPACTS

Most factories shut for Chinese New Year (CNY) from January 20 to 31.

CNY extension to February 10 created an additional twelve days of shutdown.

Where factories are reopening, work force is not returning to full strength, reducing the production level and increasing risk to inventory and sales.

Many supply chains rely on parts from other factories, which may be closed or running at reduced output. A single missing part/raw material can impact finished goods production.

Supply chains operating with minimal inventory buffer will start to see risk with almost two weeks of lost production.

As factories ramp up, they will likely run additional shifts/overtime to make up for lost time, and thus costs will increase.

TRANSPORTATION IMPACTS

Transportation into and out of China has been cut (US airlines cancelled China flights until late April).

Production shutdown has caused cancellation of vessel sailings, which drives imbalance of empty containers.

As production ramps up, shipping will be in a constrained network and cause heightened demand for an express shipment network with limited options.

Once production is fully back on line and pushing for higher production levels, the logistic network will struggle to support the surge in freight volume.

Increases in logistics costs are likely, as the demand/capacity imbalance will drive increases in pricing to handle the needed surge capacity.

Retail Feels the Pain—What are the Impacts?

The above noted issues in production and transportation will likely result in inventory shortages for lean supply chains where China is the primary or sole supplier. As closures and transportation issues continue, supply chains with previously large inventory buffers will start to experience shortages. Delays in later-season buys could also occur as production for summer and fall product may be delayed. How retailers manage and utilize inventory will prove critical in the months to come.

Revenue Pressure

Some retailers—particularly luxury brands—are bearing the brunt of the crisis due to their significant retail presence in China. Chinese consumers accounted for 40 percent of the total spending on luxury goods in 2019¹. Chinese luxury shoppers were responsible for 80 percent of 2019 sales growth, making Chinese consumers the fastest growing luxury shopper demographic globally².

Retail shopping in China has felt the impact beyond luxury retailers; other major brands have a significant retail footprint in the country, including Nike, Puma, and Adidas. Many retailers have reduced revenue forecasts for the coming quarter(s) as extended factory closures lead to launch delays and international sales are hurt with stores in China remaining closed or operating limited hours.

For stores outside of China, the potential revenue hit is very real. The recent spread of the virus to Italy has demonstrated that this is not a China-only problem. Should the virus spread in a significant manner in the US, we could see domestic retail stores suffer sales declines or, worse, shut down for a period of time if quarantines are implemented.

Reduced tourism has already started to hammer businesses in China. As we see public reaction to the spread of the coronavirus manifest itself in reduced travel, then spending on airfare, hotels, resorts and theme parks, national parks, etc.—and retailers and consumer-facing businesses that depend on consumer travel for revenue—could experience significant declines.

For stores and service businesses that are able to keep their doors open, the crisis could result in constrained or delayed supply of products. Reduced inventory on basics, delayed product launches, shortages of seasonal goods, and a shift to online purchases could come into play. For example, back-to-school product is already at risk of not shipping on time to meet critical time windows.

Cost of Goods Pressure

As we move through this crisis, costs could increase, impacting retailer profitability. Product cost increases loom as companies pay for limited capacities or factories pass on overtime costs as they run at higher overtime rates to make up for lost production. Competition to tap into constricted production and logistics capabilities will drive up costs. Retailers may need to absorb the cost of dark or low-traffic stores, as rents and associated occupancy costs will not go away. On the labor side, what will companies do to retain full-time employees and managers in a tight labor market?

Chinese consumers accounted for 40 percent of the total spending on luxury goods in 2019.

1 Elizabeth Paton, "Shuttered Stores, Fewer Tourists: Luxury Feels Coronavirus Effects,"

New York Times (February 14, 2020), available at: <https://www.nytimes.com/2020/02/14/business/coronavirus-luxury-retail.html?auth=login-google>

2 Ibid.

What Can Retailers Do?

At some point, the global threat posed by the coronavirus will be mitigated, and retail, along with other business sectors, will get some good news and see business operations return to normal. But this crisis should serve as a reminder to retailers that having a Plan B (and beyond) is an important part of critical strategic planning. Negative effects recently felt from tariffs should have taught the lesson already, but this latest wave of disruption should hammer home that point.

What is the call to action for retail? Our view is that retailers need to assess the challenges through a logical set of steps that build the capability to react and rebound. Our proposed paradigm involves five stages: (1) assess risk; (2) monitor changes closely; (3) develop options in sales, inventory, and supply plans; (4) react to short-term challenges and opportunities; and (5) plan for the rebound.



Within this paradigm, we see a number of critical actions for retailers to de-risk supply chain and production issues:

1. Assess risk: *Know where you are most exposed*

- Identify key categories at risk of shortages.
- Define key categories with demand/sales risk.
- Review impacts to product inbound flow and floor set dates.
- Evaluate shifting the product flows against floor set and seasonal set dates.
- Segment/triage product categories by those most impacted (supply and/or demand).

2. Monitor supply, availability, and demand: *Ensure you know when impactful events occur*

- Implement/enhance process to communicate with Chinese vendors to track order status back through raw material/parts supply.
- With current information on orders, quantify impact on product availability.
- Quantify impact of regional consumer slowdowns—stores in China, Italy, and tourist locations—on product supply needs.
- Develop tracking of impacts for categories/products most at risk.

3. Develop options in sales, inventory, and supply plans: *Know how you can react*

- Establish promotional and markdowns strategies for options to manage unit sales with less inventory:
 - > Can promotional plans be recalibrated (e.g., not to discount as deeply), paying particular attention to pricing and promotions for fashion and 'on-trend' product?
- Identify options to maximize current inventory to where either supply, demand, or both are constrained:
 - > Should inventory be held back versus allocated to stores?
 - > Can inventory be shifted from region to region?
- Define options to minimize effect on sales—production and/or expedited logistics:
 - > Assess additional sourcing from already approved/engaged suppliers outside of China. Example: Dual sourcing t-shirts in China and India; move the China production to India as much as possible.
 - > Focus limited available production capacity and logistics capacity on most important products/product categories
- Develop strategies for both seasonal and basic products. Each will respond differently.
- Create timeline tying key decisions to key changes in supply disruption/demand changes.

4. React: *Respond to potential scenarios with predefined options and timing*

- Activate a team to respond to the changes and act quickly.
- Anticipate an uptick in ecommerce orders and ship from store.
- Launch the development strategies/action based on events and foreseen impacts.
- Execute the plans carefully, in a timely manner, and with confidence.

5. Rebound: *Build capability for the future—both short and long term*

- Engage potential new suppliers; begin vetting to open up lines of supply to diversify supply.
- Leverage new inventory levels to re-set promotional and markdown levels.

Conclusion

The unfolding of events going forward—in both the short and long term—is unknown. No one knows when supply chains will return to normal, which reinforces the strategic necessity for companies to develop scenario plans with short-, mid-, and long-term actions.

Business plans such as those proposed above, along with tight monitoring of the global situation, will help retailers make informed decisions to minimize risk and optimize operations in a difficult environment. It is important above all to avoid knee-jerk reactions that may be shortsighted and hurt performance in the medium to long term. Panic is never a good strategy.

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