The worst may be yet to come for global supply chains

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By Rosemary Coates · March 18, 2020

America is starting to awaken to the threat of the coronavirus pandemic in humans. For global supply chains, the worst is yet to come. We are already experiencing shortages of consumer goods as Americans stock up on supplies. This is just the beginning.

Inventory Is Running Out

Most industrial companies have 30-60 days of parts and raw materials either on hand, in-transit, or obtainable on short notice. After these supplies run out, we will start to see shortages of finished products as well as parts needed to produce other goods. Shortages will start to become more evident toward the end of March and beginning of April. Production in some non-Chinese factories will have to be put on hold for lack of parts. Partially finished products will remain in suspension until all parts are available to build finished products.

Many companies, especially small and medium-sized businesses do not have well-developed alternate suppliers outside of China, and finding new suppliers, qualifying them, and scheduling production is no easy task. For complicated parts, this can take 12-18 months, and it is not an inexpensive process. In some cases, currently, there are no capable suppliers anywhere in the world outside of China. Brand new suppliers will have to be identified and then developed. Some companies are pressing their engineers to redesign parts that can be sourced in the U.S., or at least outside of China. Other companies are giving 3D printing a serious try for the first time.

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Extended Factory Closures

Savvy businesses that have been sourcing products from China, know that they must build inventory just before Chinese New Year when most Chinese factories shut down. This year, Chinese New Year was immediately followed by the forced lockdown of Wuhan, China and most of Hubei province. Factories were closed throughout the region and that resulted in almost immediate shortages in the automotive and metals industries. Then the Chinese government, in an effort to control the virus, shut down factories in other areas for an additional two weeks. After the long break of Chinese New Year plus the forced extended factory closures, many Chinese migrant factory workers were reluctant to return to work.

To make matters worse, migrant workers traveling from infected areas were required to be quarantined for 14 days. When some of the factories finally reopened, workers weren't available, so production has been limping along. Many of these re-opened factories are only operating at 20-25% of normal. My sources tell me that about 50% of the factories in China are still closed and will remain so for some time.

If your company is trying to get production squeezed out of a partially-functioning factory, a potential strategy is to offer a monetary incentive. Paying a production premium of 15-20% may be enough to prioritize your production to the front of the queue. Offering more business in the future as an incentive probably won't work, as Chinese manufacturers are aware that most of their American customers have plans to source elsewhere, outside of China. They won't believe your promises of future business. But monetary incentives are almost always successful. Beware though, we are hearing stories that some factories may request additional up-front funds from you, then disappear or simply shut down the factory and walk away with your money.

Increasing Cost

The rising cost of air and ocean freight out of China is another consideration. Airfreight rates have soared with the cancellation of American, Delta, and United flights and the loss of their belly cargo space. Demand has also increased as U.S. companies scramble to get products out of China.

The slowing of factory production has resulted in cancellations of container ship sailings from China, which in turn has caused an imbalance in containers moving between the U.S. and China. Sea-Intelligence reported last week that a total of 77 container-ship sailings had been blanked (canceled) due to coronavirus — 48 trans-Pacific and 29 Asia-Europe. Surcharges for rebalancing empty containers are beginning to emerge.

When markets begin to eventually recover, it will be some time before operations return to normal and the workers return to their port jobs.

Make Your Supply Chains Resilient

Some companies started planning alternate supply chain strategies when the trade wars didn't end as expected. Other companies decided to wait it out and maintained their Chinese suppliers. The coronavirus has been a double-whammy clearly demonstrating the need for alternate strategic supply chain planning now and in the future.

We have been working with clients to identify new locations for factories (including the US) and finding new suppliers in other low-cost nations. Mexico has become a viable cost alternative to China. Even if you chose to continue to manufacture and source in China to serve your Asian customers, developing alternate plans and developing alternate suppliers are good ideas to mitigate risk.

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Ms. Coates is the Executive Director of the Reshoring Institute and the President of Blue Silk Consulting, a Global Supply Chain consulting firm. She is a best-selling author of: 42 Rules for Sourcing and Manufacturing in China and Legal Blacksmith - How to Avoid and Defend Supply Chain Disputes. Ms. Coates lives in Silicon Valley and has worked with over 80 clients worldwide. She is also an Expert Witness for legal cases involving global supply chain matters. She is passionate about Reshoring.