PRIMEIRO PARTNERS

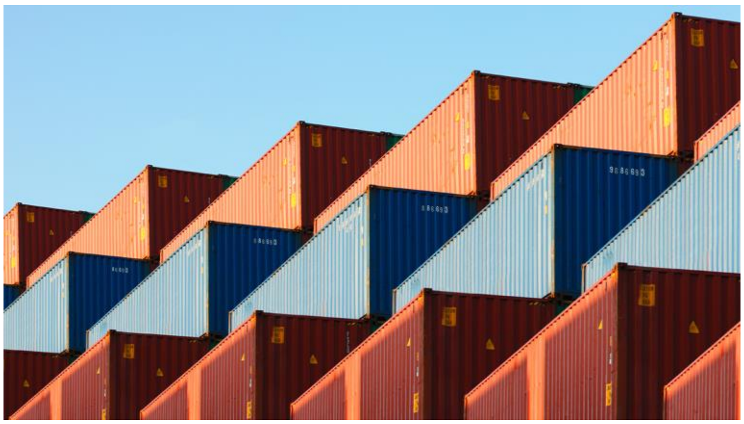
The Daily Dispatch

Weekly Special Feature

November 18, 2022

5 Lessons from Automakers on Navigating Supply Chain Disruptions

By: Darrell Rigby, Hernan Saenz, and Peter Guarraia *(Published on November 16, 2022)*



Paul Taylor/Getty Images

As the frequency and magnitude of supply chain disruptions continue to grow, it would be understandable if business leaders' first instinct is to respond by trying to correct every single flaw or mistake, no matter what it takes, so each disruption never happens again. But it's becoming increasingly clear that a 100% resilient supply chain is unattainable. Rather, pragmatism and adaptability are proving far more effective.

This is the approach that a number of automakers are embracing. Now, as businesses in every industry reorient their supply chains to boost resilience, the strategic ways the automotive sector has responded to recent supply chain shocks hold lessons for all companies.

Here are five actions for executives to consider as they craft the resilience strategy that's right for their company.

1. Deliver the "good enough" product.

Some auto companies are avoiding shipping delays by adjusting or even eliminating non-essential features or components. Their calculus is that after all the supply issues of the past few years, customers are more willing to accept a product that doesn't give them everything they want.

Automakers, including General Motors, have removed driver-assistance systems and other features that rely on unavailable computer chips. As the chip shortage eases, there's an open question about when automakers will reverse these decisions. For example, if an analog control panel is cheaper than a digital one and customers don't mind analog, does it make sense to switch back? Weighing customer preferences, the competitive landscape, and supply availability will guide companies to the right answer, both in the short and long term.

2. Develop better monitoring systems.

In an era of instability and uncertainty, executives may feel that if they invest enough money in the company's prediction capabilities, they'll know where to focus their efforts to increase the resilience of their supply chains and can make big, long-term bets with confidence. But if the past few years have taught us anything, it's that even the most sophisticated model can't predict everything.

Instead of overinvesting in prediction, some companies are creating better systems to monitor their most critical links in the supply chain and flag potential issues in real time. In addition, they're looking for ways to accelerate their response to that new information. This entails an organizational mindset shift, so the company focuses less on transitory events and more on increasing its agility and adaptability.

One automaker responded to pandemic disruptions and the chip shortage with significant investments in bolstering its ability to monitor risks and respond. First, the company created a new tool that uses a scoring system to triage risks. Realizing that the thousands of things, from raw materials to finished goods, that go into its end products are too vast to feasibly invest in foolproof resilience for everything, it instead developed and codified risk assessments for a subset of hundreds of components that are most crucial for delivering a finished product that meets customer needs.

The system assigns scores to each critical component and commodity based on types of risks, such as environmental, geopolitical, lead time for production capacity, and geographic concentration of suppliers.

As part of this, the company also evaluated thousands of metrics that would enable it to better predict risk to those most crucial supply inputs and quickly react. Metrics include monitoring commodity price exchanges (to better track supply-demand imbalances) and suppliers' production capacity utilization (to better understand lead times and supplier health). It invested in digital tools and other information-gathering mechanisms to closely watch those disruption signals, so it could stay ahead of them as much as possible.

A key principle of the new strategy is ruthless prioritization. The organization now tries to act quickly when urgent risks to its most critical components arise; monitor leading indicators for less-urgent, longer-term risks; and consider investing in supply redundancy where it matters most. Meanwhile, the company has deprioritized lower-risk categories, with a plan to revisit them in the future.

This revamped risk-assessment approach has already uncovered potentially significant vulnerabilities that were difficult to spot — one was additive materials required to produce a resin used to bind the cathodes and anodes in lithium-ion vehicle batteries. The company found that this additive has a small number of suppliers concentrated in few regions and the suppliers are running at their maximum production capacity, meaning disruptions to any of these suppliers' operations could limit the automaker's access to this critical material. The company is currently planning potential countermeasures.

Lastly, the company designed a comprehensive operating model to support the new supply-chain-resilience strategy and cement it throughout the company. This included creating a new team to oversee the company's resilience efforts and defining processes and a governance structure for addressing potential supply threats and responding to disruptions. New processes and responsibilities for this team include scenario planning, stress testing the supply chain, and facilitating risk-prioritization discussions across all supply chain functions. These investments are helping the company build a culture that emphasizes resilience. Now, instead of being reactive to supply crises, the company has clear plans in place for proactively mitigating risks when enough warning signs appear.

Although it's difficult to project the impact of these resilience investments since every supply chain disruption is different, they could easily save the company hundreds of millions of dollars when the next major supply shock hits.

3. Resist the urge to centralize decision-making.

As companies develop more intelligent systems for monitoring their supply chain and responding to disruptions, there's often a gravitational pull toward consolidating decision-making power within a single team overseeing resilience. But the reality is that centralization can create delays in responding to issues that the company can ill afford.

A better approach is to strike a balance between centralized and distributed decision-making. One automotive business adopted a hybrid model that put tactical or more straightforward decisions in the hands of employees working on the ground in day-to-day supply chain operations, while the central supply-chain-resilience team has control over larger decisions that might involve significant investments or affect the company's full supply chain.

For example, the procurement team is empowered to make targeted changes to inventory policies, while the central team makes strategic decisions such as ranking the list of priority risks and responses across the company's supply chain. The company expects this structure will help it react more nimbly to timely issues while ensuring proper diligence for changes with larger ramifications.

4. Identify pragmatic ways to ensure supplies of crucial resources.

Companies have a range of options to try and ensure uninterrupted access to their most critical materials and product components. Some of the most common solutions include paying premium prices to suppliers to secure access;

sourcing parts or materials from multiple suppliers; redesigning the end product to rely on alternative inputs that are more widely available and less specialized; standardizing more components across the company's suite of products; and co-investing with suppliers to increase manufacturing capacity.

However, for rarer parts and materials these options might not be possible or completely solve the issue. Executives might be tempted to bring production of the most precious resources in-house or, in the case of rare minerals, even get their company into mining them itself. But taking over direct production or sourcing is expensive and could drag down company performance as it siphons money away from the core business.

As an alternative, some companies have begun to explore circular business models to give them better control of scarce resources. For example, Toyota is leasing, instead of selling, its electric vehicles in Japan so the company can maintain ownership of the batteries in order to reuse them as appropriate or recycle key materials. This model is expected to reduce risks and costs, hedge the company against shortages of the metals required to produce electric vehicle batteries, and make its cars more environmentally sustainable.

5. Turn scarcity into a virtue.

When faced with supply uncertainty, the inclination is to simply order a surplus to provide a buffer. (Why not build up an extra 30 days' worth of inventory than normal?) The problem is the situation can change overnight, as all executives are painfully aware after the supply ups and downs of the past couple years. Staying ahead of the "bullwhip effect" is becoming trickier. Some companies over-ordered inventory in the past two years, spent money on extra space to house it, and now those goods are sitting in storage, losing value or being sold at fire-sale prices.

Some companies are finding creative ways to turn the inventory problem into a business opportunity. Pandemic-induced manufacturing disruptions and parts shortages shrank one automotive company's supply of its end products to less than half its usual inventory buffer. That, in turn, led to some customers accelerating their purchases so they could grab their desired model before it went out of stock; reduced supply (along with inflation) then pushed up prices. Unexpectedly, the scarcity didn't turn customers off: If they were already intent on buying a particular model from the company, many were willing to wait to get the one they wanted, and in many cases higher prices didn't change their calculus.

This revelation made the company rethink its go-to-market model for select premium models and vehicles with special features or colors. It's early days, but for this subset of products, the company is less concerned now with accurately forecasting the right number of specific vehicle models it should deliver to the dealer locations where they're most likely to sell. Instead, the company is experimenting with staging that inventory in strategically located warehouses where those particular products can quickly be delivered to dealer lots as orders arrive. Dealers can then turn scarcity into a premium experience for customers: If they don't have the desired vehicle on the shop floor, they help customers search the company's full inventory and place the order, and then it gets delivered rapidly.

One of the overarching lessons is the pandemic and other supply disruptions of the past few years have reset customer expectations in several key areas. This may not last forever, but there's an opening for companies to use it to their advantage and find innovative ways to meet or even exceed customer expectations.

Source: Darrell Rigby, Hernan Saenz, and Peter Guarraia (2022). 5 Lessons from Automakers on Navigating Supply Chain Disruptions. *Harvard Business Review*. Available at: https://hbr.org/2022/11/5-lessons-from-automakers-on-navigating-supply-chain-disruptions

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TODAY'S TOP NEWS

NGCP signs over P30b worth of new contracts

Synergy Grid & Development Phils. Inc. said Thursday its sole operating asset National Grid Corp. of the Philippines signed new construction contracts amounting to P30.19 billion as of end-September.

Max's 9-month profit jumps by 82%

Max's Group Inc., the casual dining restaurant operator, said its income in January to September grew 82 percent to P427.32 million from last year's P234.5 million. The company said last year's income included a one-off gain of P377 million from the sale of a subsidiary whose primary asset is land.

SMC waives toll for 84K cars

Due to a network outage in its electronic toll collection platform, San Miguel Corp. (SMC) had to waive the toll for roughly 84,000 motorists that were affected by the traffic jam along portions of its expressways on Thursday.

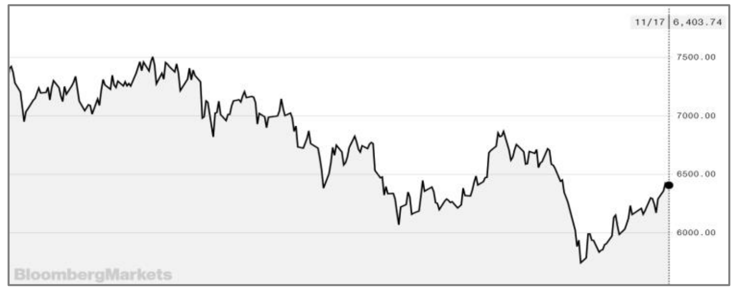
Filinvest Land income down 37%

Filinvest Land Inc., the listed property development arm of the Gotianun Group, said its attributable income in Jan to Sep. fell by 37% to P2 bn from the previous year's P3.18 bn. The company noted that it recorded a P1.1 bn income tax benefit last year due to the Corporate Recovery and Tax Incentives for Enterprises Act.

Prime Infra to spend P55B for energy, water proj.

At a press briefing on Thursday, Prime Infra President and CEO Guillaume Lucci said the company is "well-positioned" to build projects supporting most urgently needed sustainability goals—energy, access to clean water, waste management and viable critical infrastructure.

Philippine Stock Market Update



Previous Close:
6,403.74

1 Yr Return:
-9.98%

Open:
6,415.34

YTD Return:
-9.42%

52-Week Range:
5,699.30 - 7,552.20

Source:
Bloomberg

Foreign Exchange

As of November 17, 2022

US Dollar	Philippine Peso
1	**57.45**

BVAL Reference Rates

As of November 17, 2022

Tenor	Rate
1Y	**5.069**
3Y	**6.450**
5Y	**6.822**
7Y	**7.066**
10Y	**7.511**
20Y	**7.854**

Daily Quote

"The past may dictate who we are, but we get to determine what we become." – *Stephen Spielberg*

MORE LOCAL NEWS

Filinvest REIT adds P1-B Boracay land to portfolio

FILINVEST REIT Corp. (FILRT), the commercial real estate investment trust (REIT) of the Filinvest group, has approved the acquisition of 2.9 hectares of land in Boracay for P1.05 billion.

NLEX Connector Caloocan-España set to open

NLEX Corp. announced on Wednesday that the Caloocan-España segment of its connector road project is now more than 90% complete and can be opened to motorists in December this year.

Sta. Lucia Land's inc. more than doubles to P918M

LISTED real estate developer Sta. Lucia Land, Inc. (SLI) recorded P917.75 million in third-quarter attributable net income, more than twice higher than P406.87 million a year ago, on higher revenues. In the 3 months ending September, the company's top line rose 27.9% to P2.27 billion from the P1.78 billion it booked last year.

Globe seen on track to meet 2022 revenue target

GLOBE Telecom, Inc. is on track to achieve its full-year target of mid-single digit revenue growth, financial research firm CreditSights, Inc. said, citing sustained subscriber demand. The company is also on track to meet its EBITDA margin target of 50%, Fitch Group's CreditSights said.

SEIPI clings to 10% export growth goal this year

THE SEMICONDUCTOR and Electronics Industries in the Philippines Foundation, Inc. (SEIPI) is clinging to its 10% export growth target this year, as it expects higher demand during the holiday season.

DOE: Foreigners may now explore PH renew. energy

Foreign investors or companies may now engage in the exploration, development, and utilization of the country's renewable energy resources after the Department of Energy amended the Implementing Rules and Regulations of the Renewable Energy Act of 2008, following the opinion by the Department of Justice on September 29, 2022.

Deficit-to-GDP ratio eases to 6.5% in Q3

The share of the budget deficit to the country's output slightly softened to 6.5 percent in the third quarter, with a further downtrend seen in anticipation of continued economic growth. This is significantly smaller than the 9.2 percent deficit-to-GDP ratio in the same period last year.

BOI OKs P35.2-M IT-BPM service provider in Taguig

The Board of Investments (BOI) has approved the registration of a new information technology-business process management (IT-BPM) service provider company which will be opening a site in Taguig City. In a statement on Wednesday, the BOI said it approved the application to register of DB Results (Philippines) Inc.

Vehicle sales up 31% in 10 months

Vehicle sales in the country continued to post double-digit growth in the 10 months of the year, according to data from the Chamber of Automotive Manufacturers of the Philippines Inc. (CAMPI) and Truck Manufacturers Association (TMA). Year-to-date new motor vehicle sales increased by 30.9% to 280,300 units.

Reopened economy pushes up EastWest's Q3 inc.

EastWest Banking Corp. saw its bottom-line surge in the third quarter, as looser pandemic restrictions facilitated credit expansion. In a disclosure sent to the Philippine Stock Exchange on Wednesday, the Gotianun-led bank reported its net income soared 17% year-on-year to P1.5 billion in the July-September period.

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TODAY'S TOP ASIAN NEWS

SoftBank unit seeks $215m in Paytm stake sale

A unit of Japan's SoftBank Group is selling a 4.5 per cent stake in the parent of India's leading digital payments brand Paytm, seeking to pare back its holding in a company whose share has tumbled 72 per cent since its initial public offering (IPO) last year.

Vietnam nears $11b deal to shift economy from coal

VIETNAM is set to follow Indonesia and South Africa with a climate financing package of at least US$11 billion to shift its economy away from coal and boost the rollout of renewable energy sources.

Temasek to write down US$275m in FTX

State investor Temasek will write off its US$275 million (S$377 million) investment in cryptocurrency firm FTX, "irrespective of the outcome of FTX's bankruptcy protection filing". Temasek said the total cost of its investment in FTX was 0.09 per cent of its net portfolio value of S$403 billion as of end March this year.

Grab's Q3 net loss narrows to US$327m

South-East Asian on-demand player Grab narrowed its net loss to US$327 million for Q3 ended September, an improvement from the US$970 million loss a year ago. This was primarily due to the elimination of non-cash interest expenses from Grab's convertible redeemable preference shares upon its December 2021 listing.

Rakuten seeks US$500m in rare junk bond offering

Rakuten Group is marketing a US$500 million (S$685 million) bond to bolster the Japanese Internet company's struggling mobile unit, in a test of demand for a rare junk debt offering from the country and a borrower under financial strains.

TODAY'S TOP GLOBAL NEWS

Nvidia sales beat est.; data-centre fuels growth

NVIDIA, the most valuable US semiconductor maker, posted quarterly sales that topped analysts' estimates after its data-centre business helped offset sluggish demand for video game chips.

Budweiser buying back $3.5b bonds to cut debt

EUROPE'S most indebted brewer is seeking to buy back bonds in a move to further reduce its large debt pile. Anheuser-Busch InBev will spend as much as US$3.5 billion buying back dollar and pound denominated notes through Dec 14.

Gold flat as geopolitical tensions ease

GOLD prices were flat on Thursday (Nov 17) as safe-haven demand from latest geopolitical concerns faded, while hopes that the US Federal Reserve would be less aggressive on rate hikes over coming months underpinned the market.

Crypto lender BlockFi plans bankruptcy filing

Cryptocurrency lender BlockFi is preparing to file for bankruptcy within days, according to people with knowledge of the matter. The crypto lender paused client withdrawals, citing uncertainties with FTX, while saying it had adequate liquidity and was exploring options with outside advisers.

Energy prices drive UK inflation to 41-year high

Soaring energy bills drove UK inflation even higher than expected to a 41-year high in October, adding to pressure on the Bank of England to raise interest rates again. The Consumer Prices Index rose to 11.1 per cent from a year ago, the Office for National Statistics said Wednesday.