Voice of the CSCO

Domino effect: Keeping supply chains balanced as tensions rise

KPMG hosted the latest in a series of peer group exchanges during which chief supply chain officers (CSCOs) across multiple industries participated in a discussion about combatting internal and external supply chain pressures. Rob Barrett, U.S. Supply Chain Advisory leader, and Brian Higgins, U.S. Customer and Operations leader, were joined by Meagan Martin, an economist with KPMG Economics.

Key takeaways

- Keeping track of complex and evolving macroeconomic indicators is becoming increasingly crucial to supply chain resilience. To manage volatility through both short and long cycles, supply chain leaders require deeper and more regular data and analysis on supply chain impacts of inflationary pressure, geopolitical developments, and wage and labor challenges.
- Enterprise resource planning (ERP) system consolidation is a top agenda item, but complex supply chain ecosystems face multiple challenges as they move from patchwork solutions toward a consistent core. Change management stands out as a particular sticking point at the later stages of multiyear ERP implementation programs.
- Corporate commitments to advance toward environmental, social and governance (ESG) goals continue to gain momentum and attention, with direct impacts on supply chain priorities. Greater engagement and transparency through the end-to-end supply chain, including requirements, activities and controls of vendors around the world, are foundational requirements for companies to operate sustainably and responsibly.

Microscope on macroeconomics

Red-hot inflation. Oil and gas shocks. Shortage of labor across suppliers. The biggest risks of today's supply chains are tied to complex economic and geopolitical factors in play around the world. At the same time, supply chain problems exacerbate macroeconomic issues: think disrupted production and shipping driving higher transportation costs and inflation. In this cycle of market unpredictability, it is more important than ever to bolster global supply chain agility and resilience.

Predicting inflation and its supply chain impacts

Getting products to satisfy demand was a major story in most industries through 2021. While there's continued uncertainty around continuity of supply, inflation has now taken over the headlines, putting a new level of scrutiny on inventory and working capital reduction across supply chains.

Inflationary pressure continues to hammer companies and doesn't appear to be letting up. While headline inflation is coming down, headline consumer prices understate the impact of inflation, Martin said. In August, core inflation accelerated[1] by 0.6 percent, up 6.3 percent from a year ago. The bottom line, according to KPMG economists, is that we may enter an official recession in the U.S. and a global slowdown as early as Q4 2022 or the first half of next year.

As pricing pressures mount, supply chain executives want to know when the pain will end. But multiple interconnected factors across multiple interconnected markets make trying to predict and prepare for what's to come a daunting task—and a moving target.

> You almost need an economist to predict inflation for the next couple of years.
>
> *–Supply chain executive*

"A lot of the potential shocks on the horizon are inflationary by nature, whether that's the European energy crisis, or the labor situation," said Martin.

Real-time analysis of economic markets and developments are key guiding points for actions. CSCOs said they are closely tracking monetary policies of the Federal Reserve in the U.S., the European Central Bank (ECB) and central banks in E.U. countries to quell inflation. In the U.S., the Fed hopes to trim inflation to 2 percent. The Fed has only recently moved to a neutral policy and is not yet in contractionary territory. As such, Martin said she expects the next move to tighten borrowing by the Fed to be a 100 basis point rate hike, with more hikes on the horizon.

Like inflation itself, central bank tightening will be a global phenomenon, demonstrated by the 75 basis point hike in September by the European Central Bank (ECB)—a record for it.[2] According to Martin, most central banks are following the Fed to tame inflation and currency depreciation. Select markets, such as Canada, vote to stay slightly above the Federal Reserve, while only a few central banks, such as Japan, have no plans to tighten rates.

A key question facing supply chain leaders is whether central banks are going too far—tightening rates so much it causes a deeper global recession than currently anticipated. Although timing is difficult to predict and outlooks change frequently, Martin said a global demand slowdown is likely, but one that will improve as inflation comes down and central banks loosen policy rates.

To endure the current inflationary cycle, one CSCO said his business is moving operations from China to Mexico and the U.S. as part of an enterprise-wide initiative. KPMG research indicates many other companies are implementing the same general strategy: Near-shoring into the Americas is a popular tactic to mitigate inflation, according to the recent KPMG inflation survey.[3]

Preparing for a potential European energy crisis

Worries over energy resilience in Europe are top of mind for CSCOs of businesses with global supply bases. A confluence of factors is driving the continent's unfolding power emergency, including: the Russia invasion of Ukraine, which disrupted exports of gas, high prices for alternative gas suppliers and nuclear power plants driven offline by climate change.

Countries are currently looking to shore up gas supplies and implement energy saving measures to manage demand before winter. Back up plans include turning off nuclear power and turning on coal furnaces. But another shock to oil and gas is a high probability event given new rounds of sanctions this fall and winter, Martin predicted.

> I would say the European energy situation is one of the most volatile inputs in the short term.
>
> *–Supply chain executive*

CSCOs said they are focused and putting contingencies in place for potential energy shortages in Europe and are generally resigned to what the costs will be.

One tactic for mitigating the impacts of the unfolding European energy crisis is hedging and forward purchasing. "We have been buying ahead with providers in European markets," a CSCO said.

One company has pivoted from a very conservative to aggressive approach of commodity price risk management. The company is exploring fixed price contracts to eliminate volatility of an energy crisis across multiple commodities coming out of Europe, the CSCO said.

[1] Source: KPMG Economics, "August core inflation sizzles, August 2022

[2] Source: Reuters, "ECP raises rates by unprecedented 75 basis points)," September 8, 2022

[3] Source: KPMG Economics, "KPMG Insights on Inflation survey" September 2022

> The potential volatility of the energy crisis in Europe could impact specific commodities so we are taking a more aggressive look at things like fixed price contracts to try to manage those risks.
>
> ***—Supply chain executive***

Improving visibility into the European supply base is also important, especially for suppliers that don't have ability to buy ahead. One company is canvassing the supply base to understand impacts and actions. Another is ramping up supply chain mapping with an energy lens. "We have assets in most European countries, including converted plants. What we are missing is our suppliers; they will be the ones impacted," the CSCO said.

Accessing a new crop of labor

The threat of a rail strike. Labor disputes in U.S. ports. Absenteeism. Baby Boomer retirements. The rise of the gig economy. Rising salaries. Labor issues through all tiers of the supply base continue to challenge CSCOs, driving inefficiencies at ports, roads and rails, exacerbating logistics and distribution delays, and increasing the cost of doing business.

Although shortages of dockworkers, truck drivers, and warehouse staff are less pronounced than in 2020 and 2021, structural changes in the work environment, coupled with wage rate inflation, are driving CSCOs to explore new approaches to hiring, talent management, and workforce development.

One CSCO said government safety nets have made it difficult for his company to staff entry level jobs. He will be closely watching the midterm elections, which could drive a change in policy. According to another CSCO, wages in distribution centers are a top concern. "Every time we hire a person it seems like they go down the street and get two bucks more from a competitor," the CSCO said.

> We are seeing the labor market softening. It is not back to pre-pandemic health, but it is a lot healthier than it was a year ago.
>
> ***—Supply chain executive***

One company is turning to labor automation to ease wage rate pressures. "We're moving with both feet toward automation just to lower our dependency on labor," the CSCO said.

Picking up and moving operations is complex, costly and time-consuming, yet some markets are unprofitable enough that companies are considering it. Having exhausted current talent sources, one company is exploring ways to geographically access a new pool. Another company's operational changes made during the pandemic to build up the domestic supply base have helped it deal with the current labor situation. "We're able to retain talent and not have the dependence on outside labor that we have in the past. This shift was inspired by container cost and port congestion, which made North America and domestic producers more attractive and stable," the CSCO said.

KPMG perspective:
The macroeconomic environment has major impacts on the volatility that supply chain executives are trying to manage. CSCOs should consider moving economic and geopolitical data and insights to the front and center of their decision-making. This is not a one-time activity. A dynamic view of what is changing, week to week and even day by day, is required for CSCOs to pull the right financial and operational levers at the right time to maintain supply chain continuity and resilience.

Quick wins on long ERP consolidation programs

It is not at all uncommon for large global organizations, especially those that have made multiple acquisitions, to run multiple ERP systems supporting different supply chain-related business processes—sometimes even within single geographies or business units. But it is also not an ideal scenario. Information redundancies, nonstandard data formats, and cumbersome processes are some of the supply chain management problems resulting from patchwork ERP environments.

There are numerous potential benefits to be gained from ERP platform consolidation. Greater standardization and interconnectivity helps create operational synergies, streamline processes, and improve supply chain transparency by enabling single views of operations and inventory through vendors and suppliers.

ERP consolidation is a lengthy process—sometimes so lengthy that by the time a full system is actually deployed, it is already obsolete. Companies must decide whether to move to a full enterprise-wide solution, a simple core with decoupled apps, or customizing something in the middle.

More often than not, the right choice comes down to individual business requirements. "The uniqueness in your business is what might drive differentiation between the ERP levels and solutions in the market," said Barrett.

One company on a path to a new consolidated ERP is aiming to implement a minimalist solution rather than an all-encompassing one. "We will customize a system with only the essential backbone elements and then use digital tools on top," the CSCO said.

Another company, which runs seven different ERPs across the enterprise, has a similar strategy. "We're doing the least that we possibly can to still solve our current business requirements," the CSCO said.

A company that has opted for a complete ERP fronting and backing the entire enterprise is taking the journey slowly, business unit by business unit.

You have to take it in bite size chunks.

—Supply chain executive

ERP architectures that offer loosely coupled supply chain apps enable CSCOs to more easily customize what and how processes run on the system. "Supply chain professionals can better control their destiny on the edge," Barrett said.

"A trend we are seeing now is back to skinny ERPs with optimization of the edge. It provides some freedom to meet specific needs in specific regions."

—Rob Barrett, KPMG

While highly complex, the technical aspect is only a piece of ERP modernization. The ultimate goal for supply chain functions is to enable process change, which inevitably results in people and culture change. People need to be prepared for potentially new ways of working and new career architectures and progressions, for example.

Proactive change management can help CSCOs anticipate what questions and demands might arise as a new ERP impacts functions and business units. Yet it is frequently an afterthought, approached somewhat mindlessly as leaders get bogged down with technical matters.

"We really struggle with the change management aspect of ERP consolidation," said a CSCO whose company only started thinking about change management later in its multiyear ERP consolidation journey.

Requirements management, a related issue, is another common struggle on the ERP journey.

"When requirements management goes awry, it sets the change track up for immediate failure because there's been no forethought into non-negotiable guiding principles that are critical to success and they can be violated from day zero," said Higgins.

"You've got to level set on initial design requirements with your third-party ERP vendor and create joint accountability, or scope creep will take over," added a CSCO.

One system implementation best practice is tightening up requirements management to set yourself up for success and help with overall adoption.

—Brian Higgins, KPMG

KPMG perspective:
Change management and governance should be front and center during the ERP consolidation journey. They are essential to making technology and process changes stick—especially major ones like this. Although the concept sounds fuzzy, best-in-class change management is tactical, not theoretical. For example, KPMG uses a tool called Change Frame which helps create persona-based change journeys for all the participants in a change program of all shapes and sizes. Leaders leverage the tool to gain insights on how people are progressing, check in on training and compliance testing, and spot and address challenges.

Sustainability strategies gain momentum

Across industries, sustainability is increasingly important to organizations, shareholders and investors. It's moving up the CSCO agenda, too. We hear requests from the customer base and board. One company's customers are making a big push for deforestation, and green steel is also a focus, the CSCO said.

> ESG conversations with all stakeholders is at an all-time high, whether shareholders, customers, communities we live and work in, or employees.
>
> ***—Supply chain executive***

Setting specific sustainability goals in the supply chain is a starting point for change. One company is currently determining its scope one targets, leveraging the already-defined requirements of its vendors as a key input. "I'm looking at inserting some of the sustainability commitments into our long-term agreements," the CSCO said. "I'm excited to go down the road, but very early in the process."

Companies further down the sustainability journey have made public commitments. One company has announced its science-based targets on scope one and two emissions and will soon publish its scope three commitments related to use of greenhouse gases. It has already discussed its scope three plans at its investor days. "The company is very comfortable with the commitments we made on scope one and scope two and as it relates to what we're going to do by 2030," the CSCO said.

Another company is starting to make investments in innovations like hydrogen-fueled electric power units and fleets of Teslas to move towards its sustainability goals.

Close collaboration with suppliers will be foundational to executing against the sustainability roadmap. "We've done the homework on how our upstream suppliers will impact us and we've got a council of suppliers who have signed up to support the commitments we're ready to make," a CSCO said. "We have to work in partnership with suppliers for what their plans are and push them through, because we are selling the end product to the consumer," another CSCO said. "That's a big headwind for us, but we've got good line of sight."

KPMG perspective:
ESG integration into the supply chain is mostly in the early stages. But with high attention across stakeholder groups, CSCOs are becoming more active around ESG topics and beginning to make progress through operational investments and changes. Moving past target-setting requires knowing the full end-to-end supply chain, enabling mindfulness about environmental impacts and measurement against commitments. Getting to science-based targets won't be free, but technology advances could help take the sting out. And ultimately, sustainable supply chains promise to meaningfully impact the bottom line, enhancing operational performance and resilience in a changing climate.

Additional insights

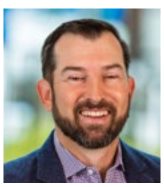
State of Supply Chain Sustainability 2022

KPMG Insights on Inflation Survey

Longing for "Yesterday" Federal Reserve Abandons Hope for a Soft Landing

Through the Looking Glass

Connect with us



Rob Barrett
U.S. Supply Chain Advisory Leader
+1 650-814-0347
rhbarrett@kpmg.com

Brian Higgins
U.S. Customer and Operations Leader
+1 773-619-1253
bhiggins@kpmg.com

Meagan Martin
Economist, KPMG Economics
+1 202-533-3000
meaganmartin1@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/socialmedia