A Perfect Storm for Globalisation?

By Mark Millar[i], Author of Global Supply Chain Ecosystems

A number of factors have combined to produce a perfect storm for globalisation – resulting in a more complex and ever-evolving landscape for business.

Mark Millar

For a whole generation, globalisation has seen producers chasing the next low-cost manufacturing location, leading to increasingly complex and convoluted global supply chain ecosystems with profound inter-dependencies.

Out-sourcing and off-shoring initiatives originally fuelled the growth of low-cost labour-intensive manufacturing in Asia. As production was unbundled on a large scale, supply chains evolved to support this shift – expanding geographically and becoming ever more complex in the process.

But more recently, the increasing cost burden of managing global supply chains has led many companies to pursue near-shoring and on-shoring strategies. This results in more regional supply chains, whereby goods are produced in – and distributed from – locations that are closer to the end consumer market.

This shift – beyond global, to a more regional approach – is a key driver in the changing landscape of globalisation, with important implications for every company engaged in international trade.

Globalisation Stalled

During the 1990s and 2000s, international trade experienced a substantial boost from mass globalisation, resulting in a huge increase in the volume of inter-continental freight flows and yielding a bonanza for logistics service providers and freight forwarders around the world.

This globalisation frenzy was fuelled by an unprecedented combination of three key drivers in the pursuit of lowest-cost manufacturing

1. the out-sourcing of business activities to third parties,
2. the off-shoring of production to low-cost countries and
3. the un-bundling of vertically integrated manufacturing clusters into dispersed specialist production activities.

Capitalising on abundant supplies of low-cost labour, massive amounts of production were out-sourced and off-shored to emerging economies across Asia, empowering the region – in particular, China – to become the factory of the world.

However, just about anything and everything that could be out-sourced and off-shored to Asia, now has been. Hence, in recent years, we have seen only modest incremental growth in trade volumes.

Developed Markets Fractured

Amongst the many complex factors behind the slowdown is the lingering Global Financial Crisis hangover-effect prevalent throughout developed markets. This is demonstrated through reduced demand for consumer goods, many of which have traditionally been imported via global supply chains.

However, also contributing to the slower growth of international trade is the recent rise in populism and protectionism, as developed markets have become fractured. A simmering under-current of anti-establishment sentiment, coupled with parts of society feeling left behind by globalisation, manifested itself through the Brexit and Trump electoral outcomes.

As articulated by WTO Director General Roberto Azevêdo *"The net positive effect of trade means nothing if you've lost your job. So we need better domestic policies to support people and get them back to work."*

This populism is being reflected in more protectionist trade policy measures as governments increasingly introduce barriers to international trade – such as tariffs – to protect their domestic industries and local employment base.

According to Global Trade Alert, during 2017 more than 600 new discriminatory trade measures were introduced worldwide, compared to just 243 liberalising measures.

The Davos 2018 gathering - entitled 'Creating a Shared Future in a Fractured World' – reported that '*economic prosperity and social cohesion are not one and the same*'.

Unintended Consequences of Global Supply Chains

Companies are also experiencing unintended consequences arising from the globalisation frenzy, namely the increasing cost burden of managing global supply chains.

The endless pursuit of low-cost labour solutions in faraway locations has had ramifications for system-wide costs. These are further amplified as the rising labour rates in China and elsewhere in Asia gradually erode the manufacturing cost advantage over developed market options.

'Total supply chain cost' is now coming into play, considering the full end-to-end cost implications. Front and centre on the business agenda are the additional cost burdens of globalised supply chains, as shown in the Exhibit below (Stank, Burnette and Dittman, 2014) which have become all too apparent through experiential learning.

Unintended Consequences - Additional Cost Burdens of Globalised Supply Chains	
TRANSPORTATION COSTS • Freight Costs • Customs Duties and Tariffs • Brokerage Fees	**COST OF SCHEDULE NON-COMPLIANCE** • Expedite Costs (Air Freight) • Stockout and Lost Sales Costs
COST OF ADDITIONAL INVENTORY • Pipeline Inventory • Safety Stock	**PAYMENT TERMS** • Cash Discounts • Payment Terms in Days Outstanding
COST OF QUALITY AND OBSOLESCENCE • Factor for Warranty Claims • Scrap and Obsolescence Risk • Inspection and Disposal Costs per Shipment	**COST OF ADMINISTRATION** • Offshore Supplier Qualification Costs • Cost of Administration Trips to Offshore Locations • Cost of Communication
RISK COSTS • Currency Risk • Country Risk • Competition (Intellectual Property) Risk • Job Switching Risk • Transportation Disruption Risk	**COST OF RESPONSIVENESS** • Lead Time Costs • Flexibility Costs • Longer Quality Feedback Loop Costs • Port Congestion Costs
Source: University of Tennessee – Global Supply Chains	

This is leading to a far more balanced analysis when producers are deciding where to locate their sourcing and manufacturing operations. Moving production activities closer to consumption markets helps shorten distribution channels and reduce freight costs.

Near-Shoring – bringing it closer to home

Many companies across the developed markets in the USA and Europe are now moving, or are considering moving, some of their off-shored production closer to home – known as ‘Near-Shoring’.

Others are undertaking ‘On-Shoring’ initiatives – also known as Re-Shoring – which means bringing production all the way home, to produce locally within the domestic market.

Whatever the terminology, these initiatives involve the repatriation of manufacturing, production and assembly activities from remote locations such as China, to geographic regions located much closer to the end consumer markets.

In many applications, near-shoring re-visits lower-cost locations that are closer in proximity to the final consumption markets – for example, Mexico for North America and countries like Poland and Hungary to serve Western Europe. North Africa is now also on the agenda as a viable production base from which to serve European markets. Hence, for many businesses there will be some production activities – though by no means all – that migrate ‘closer-to-home’. Implementing such near-shoring initiatives will result in global supply chains becoming re-configured regionally - as ‘Made in North America for America’, or ‘Made in Eastern Europe for Europe’.

Emerging Markets Developing

However, this will not result in a mass exodus from manufacturing in Asia.

Largely because of the well-established, finely tuned and highly efficient global supply chain ecosystems that service the Asia-Europe and Asia-America trades; but also because the potential of the domestic consumer markets in the emerging economies is so enormous.

Worldwide economic growth is unquestionably concentrated in the east, with the Asia Pacific region accounting for 61% of global GDP growth during the decade 2015 to 2025.

For 2018, the IMF Forecast for Global Growth is 3.9%, whilst growth across Emerging Markets is forecast almost 25% higher at 4.9 per cent.

Empowered by globalisation, many emerging markets in recent years have enjoyed increased economic prosperity, creating new consuming classes and expanding consumption markets. The workers have become the shoppers, resulting in emerging markets that are growing faster than the developed markets.

As these 'new consumers' gain access to better and more stable incomes, their increased spending drives expansion in consumption markets. This in turn leads to growth in the amount of trade amongst and between emerging markets. Latest IMF data indicates that 46% of all emerging markets' trade is with other emerging markets, whilst some 30% of developed markets' exports are destined for emerging markets.

By 2020, 1.8 billion people in emerging markets will enter the 'consuming class' (Manners-Bell and Lyon, 2015) and by 2030, Asia will be home to two-thirds of the world's middle class, up from just 28% in 2009 (Pezzini, 2012).

These trends further augment the shifting landscape beyond globalisation - to a world in which international trade - and the related freight flows and their supply chains - adopt an increasingly more regional dimension. In fact, according to Transport Intelligence, more than half of total trade during 2017 was 'Intra-Regional' trade – ie Europe to Europe (25.8%), Asia to Asia (20.5%) and North America to North America (7%).

Regional Supply Chains drive business benefits

This potent combination of implementing near-shoring strategies whilst emerging markets are developing will further reinforce the trend towards more regional supply chains.

Deploying a more regional approach can generate substantial benefits for business – in terms of time, cost and service, whilst also reducing risk. These include

- Shorter distances resulting in lower transportation costs
- Being closer to home is easier to manage (overcoming some of the challenges of managing across time zones, languages, cultures, business practices and work standards)
- Better control over product quality through proximity to suppliers

- Mitigated impact of rapidly increasing labour rates in what were ‘low-cost’ environments
- Improved ability and responsiveness to tailor products for local domestic consumer markets
- Reduced supply chain risk: less distance, fewer borders, fewer complications, less risk.

Changing face of globalisation

Globalisation was originally spurred by growth in international trade fuelled by a shift in business models as companies rushed to take advantage of lower-cost overseas manufacturing through outsourcing, offshoring and unbundling.

Now, globalisation appears to be stalling, with the pendulum shifting again.

Whether producers are responding to trade barriers arising from populist domestic policies, seeking to mitigate rising labour costs in China and elsewhere in Asia, or planning to capitalise on opportunities in emerging economies, the shift towards regional supply chains is unmistakable.

But with established and complex global supply chain ecosystems already in place, multinational companies are by no means rushing to leave Asia. Although they originally came for the workers, they now remain for the shoppers.

The next few years will present a huge amount of uncertainty for global trade and global supply chains. But one thing is certain. This evolution will never fail to be fascinating, as it presents both opportunities and challenges, and as companies grapple with the ever-changing landscape of globalisation.

References

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