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THE FUTURE OF SOURCING:

2023 & BEYOND

About this Book

The Future of Sourcing: 2023 & Beyond explores the ongoing effects of COVID-19 on businesses around the world, fragmentation of supply chains and the massive reshaping of international trade currently underway.

The book discusses how the new world trade environment has compelled companies to adapt and operate in new ways, as well as assess their strategies to mitigate risks and disruptions in the unforeseeable future. It also explores the shift in consumers' purchasing behaviors and priorities, reflecting the financial constraints the health crisis has put on economies worldwide, the accelerated digital transformation across industries and how the internet has become the primary sourcing channel for almost all B2B transactions.

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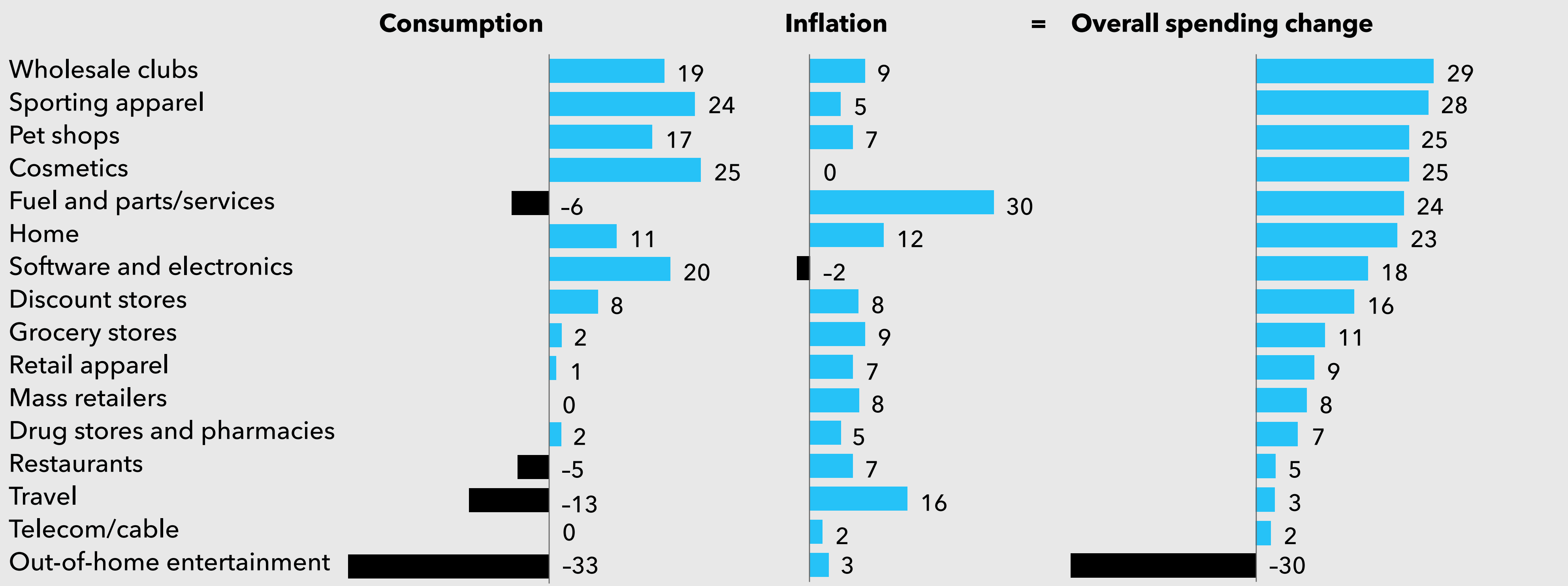
Changing Consumer Behavior

The results of McKinsey's latest Consumer Pulse survey, conducted in 2022, in addition to third-party data on consumer spending, provide insights into consumer sentiment and behavior since the COVID-19 pandemic began. Consumers bought primarily goods rather than services or experiences.

Spending on goods was higher than prepandemic levels, whereas spending on services was still 2 percent lower than it was prepandemic—a pattern that, according to McKinsey, will likely continue until more people feel comfortable being in crowds and attending public indoor events.

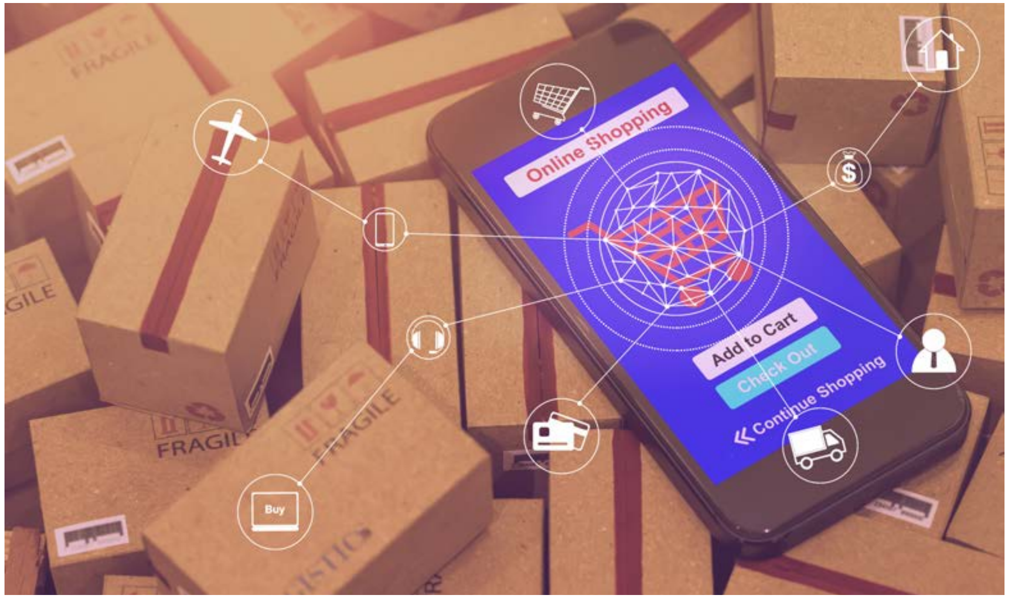
US spending growth by category, year-over year % change (Feb–March 2022)



What McKinsey refers to as "the loyalty shake-up" continues. More consumers in the US declared they had changed to different brands and retailers in 2022 than at any point since the start of the pandemic, and most said they will make this a habitual behavior in future. With inflation at an all-time high, causing what EU Commissioner Gentiloni referred to as a "sharp erosion of purchasing power [that] has shifted consumer sentiment dramatically" at the at the 2022 Autumn Economic Forecast press conference, more consumers are seeking out value; pricing is the most significant factor driving their decisions to switch brands. Of the US consumers who have switched brands, more than one-third chose to buy private-label products. According to Nikki Baird, writing in Forbes in January 2023, "there will be a definitive split between the disposable income and shopping habits of high-income shoppers vs. low-income shoppers in the year ahead – with low-income shoppers looking for any deals that will help them stretch their shrinking disposable income."

Availability, which was a big reason for switching in 2020 and 2021, still matters a lot but is less of a differentiator than at the height of the pandemic, when some brands couldn't keep up with demand and were constantly out of stock. Meanwhile, brand purpose is now less of a buying factor for consumers than it was in 2020. Novelty, on the other hand, has steadily risen in importance. Consumers are keen to try something different, making innovation an imperative for brands that want to win (or win back) consumers. Combining innovation with the perception of better value could be a particularly attractive offer.

Consumers are spending more both online and in stores. An online shopping boom took place at the start of the pandemic, through necessity. That has become a permanent change in behavior, with consumers' eyes opened to the convenience of online shopping. Even when brick-and-mortar stores reopened, spending in online channels continued to climb. McKinsey reports that year-on-year growth in e-commerce was 27 percent in March 2022.



Contrary to some industry predictions, the rise of e-commerce has not spelled doom for brick-and-mortar retail. Physical in-store spending is recovering, with 8 percent year-over-year growth in March 2022, compared with approximately 5 percent in early 2021. “Providing a seamless experience in both online and offline channels is becoming table stakes for brands and retailers,” notes McKinsey. “In addition, companies would do well to differentiate the service and experience of in-person shopping, while giving consumers reasons to continue to visit their websites and apps.”

Omnichannel shopping is becoming the norm. Seventy-five percent of US consumers surveyed by McKinsey said they now research and purchase both in-store and online. This omnichannel behavior spans food and nonfood purchases across a broad range of categories. Furthermore, 45 percent of consumers say social media influences their purchases.

Social media has the greatest influence on younger people and is most relevant in appearance-related categories such as cosmetics and sports apparel. Social commerce is well developed in Asia and is now growing in the US and Europe. Ten percent of US omnichannel shoppers said they had had made purchases directly via social media in Q1 2022. This sales channel is, says McKinsey “only growing in importance–yet too many consumer and retail executives today still haven’t taken the time to educate themselves in social media and thus are missing out on powerful opportunities to reach and engage consumers.”

Despite resuming most out-of-home activities, US consumers have not reduced spending on making their homes more attractive and comfortable. Spending on home improvement and maintenance is still growing: in 2022 it was 11 percent higher than pre-COVID-19 projections even adjusting for inflation. Given the overall shift in the way people have used their homes during the pandemic as well as many people’s expectations of continuing to work from home at least one day a week, McKinsey analysts say, this “nesting behavior” is likely to continue.

Digital Acceleration

There is no doubt that movement restrictions and other quarantine policies that forced people to stay and work from home has had a profound impact not only on what they buy but how they buy it. McKinsey described this sudden, gigantic shift to digital as "decade in days," in that normal adoption that would have taken 10 years has now suddenly materialized in just a matter of weeks or months (see Figure 3).

The rapid migration to digital technologies has drastically accelerated transformations across industries by an average of 5.3 years, according to a study conducted by cloud communications platform Twilio in June.

One of the key findings in Twilio's COVID-19 Digital Engagement Report is that the pandemic pole-vaulted some industries further than others in terms of digital transformation, with most of the shifts occurring in the following sectors:

a)	tech companies	(78%)
b)	energy	(77%)
c)	healthcare	(74%)
d)	construction	(71%)

Twilio, however, noted that the greatest acceleration in digital communications has been seen by construction businesses (8.1 years) and energy (7.2 years), while retail and e-commerce organizations report an average acceleration of 6.1 years.

The Twilio study involves a survey of 2,569 enterprise decision-makers from the UK, Australia, France, Germany, Italy, Japan, Singapore, Spain, and the United States.

FIGURE 3

Many of the trends are accelerations of past behaviors

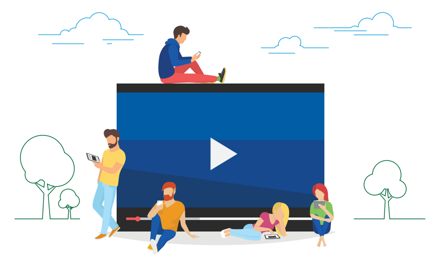
We have covered a "decade in days" when it comes to adoption of digital

Online delivery
10-years-in-8-weeks
Increase in e-commerce and online deliveries

Telemedicine
10x in 15 days

Remote working
20x participations
on videoconferencing in 3 months

Remote learning
250 million in 2 weeks
Students who went online in China



Online entertainment
Disney Plus achieved in two months what took Netflix 7 years

> *Mobile e-commerce is set to become an important part of retail and manufacturing enterprises with smartphones now a ubiquitous part of life in most cultures.*

The future is e-commerce

The pandemic has made a lot of businesses realize the importance of having online presence. E-commerce helped businesses navigate well through the pandemic and build stronger connections with consumers. Online shopping became the norm and most efficient mode for buying goods. To date, nearly 30 percent of the global population buys goods and service online. The global e-commerce market is set to reach $5 trillion by the end of 2022 and $6 trillion by 2023, per Inside Intelligence's report. The growth is being driven by sales growth in the apparel and accessories categories.

Mobile e-commerce is set to become an important part of retail and manufacturing enterprises with smartphones now a ubiquitous part of life in most cultures. The increasing use of and dependence on smartphones, as well as data integration across mobile devices, provides various growth opportunities for retailers and manufacturers.

Social e-commerce will also see a boost in utilization as popular social media platforms like Instagram and TikTok are generating massive followings and sales in unprecedented ways.

A Changing B2B Environment

The global pandemic has been pivotal in the surge in e-commerce and digital acceleration in the B2B sector. Buyers across the globe have turned to online channels to meet their purchasing needs and maintain their businesses. There's no question that B2B e-commerce is here to stay.

According to a report from *BigCommerce*, online sales on B2B e-commerce sites, log-in portals and marketplaces increased 17.8 percent to $1.63 trillion in 2021, based on research from Digital Commerce 360. The article added that data from *Statista* further suggests that the North American B2B e-commerce market will surpass $4,600 billion by 2025.

According to a study from McKinsey, about 65 percent of B2B companies across industries are fully transacting online in 2022, with more and more B2Bs opting for e-commerce over in-person sales. The same study shows that roughly 18 percent of B2Bs' revenue is generated directly from e-commerce – which is higher than phones, emails, or video conferencing.

Moreover, research from PROS – a provider of AI-powered solutions that optimize selling in the digital economy – shows that B2B buyers prefer to source from vendors that offer digital self-serve purchasing channels, are quick to respond to buyer inquiries, provide personalized and consistent pricing, and offer a transparent view of inventory.

Due to shifts in customer preferences and remote-first engagement, hybrid selling is expected to be the most dominant sales strategy by 2024. Initially an adaptation to the pandemic, hybrid selling utilizes a combination of channels, including remote and e-commerce, to enable the customer journey across multiple touchpoints. It is also flexible, scalable, and drives up to 50 percent more revenue as it provides a broader and deeper customer engagement.

In summary, expect more B2B companies to shift from "traditional" sales to "hybrid" in order to cater to consumer needs in the coming years.

The Future of Sourcing

> ***Businesses and governments in some regions have yet to fully adapt and move out of crisis mode, which makes the logistics of sourcing a more fraught and expensive business than before the pandemic, to say nothing of the effects on people's lives.***

COVID-19 disrupted supply chains worldwide, with many in the sourcing business struggling to react in the short term. The repercussions are still felt today as transmission waves recur. Businesses and governments in some regions have yet to fully adapt and move out of crisis mode, which makes the logistics of sourcing a more fraught and expensive business than before the pandemic, to say nothing of the effects on people's lives.

Professor Carlos Cordon and Eric Buatois of the Switzerland-based International Institute for Management Development propose a broad overhaul of supply chain infrastructure to enable sourcing that is responsive to the vagaries of natural and man-made disasters. They outline three paradigm shifts needed to enable a bright outlook for the supply chain future in a post COVID-19 reality: regionalization, automation/ digitalization, and autonomation.

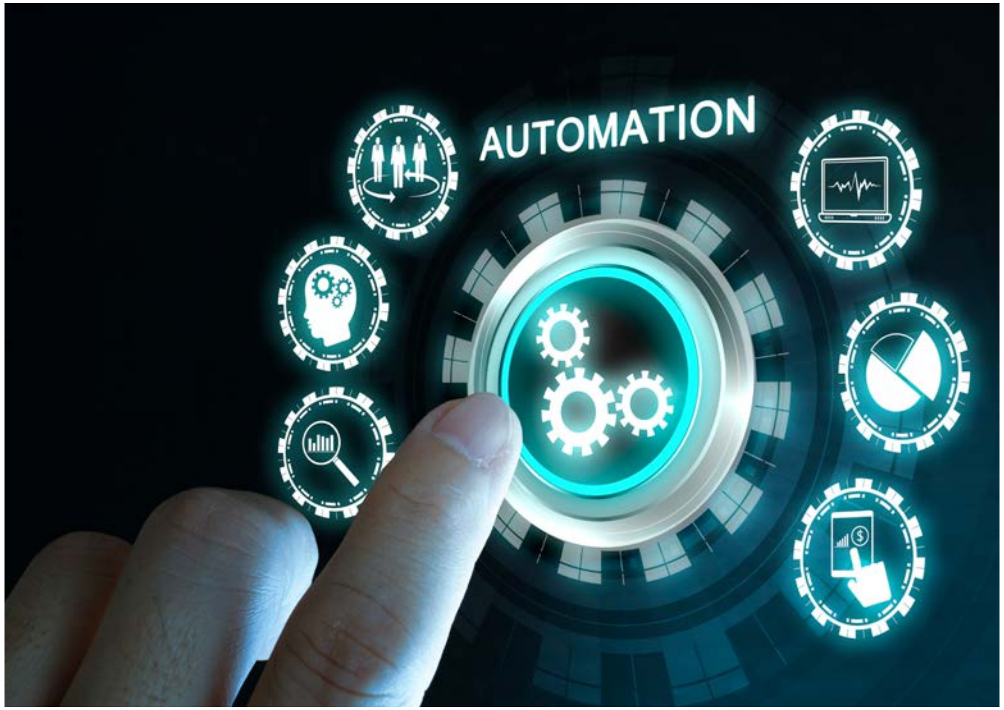
Regionalization

According to Cordon and Buatois, the pandemic exposed the hidden costs of single-source dependencies, which they deem as too rigid and inflexible to deal with unforeseen disruptions. This, they say, will lead to the re-emergence of logistics hubs at the regional level where "product integrators, sub-system suppliers and component suppliers will source, assemble and deliver from their own backyards."

In Europe, Cordon and Buatois expect the regional bloc to see the importance of drawing critical supplies from its own sphere to create a more flexible and adaptable supply chain. They note that in the pre-COVID era, Europe's pharmaceutical industry relied heavily on Asian suppliers, importing as much as 80% of the active components for its drug supply from China and India.

In a recent research report, US-based credit rating agency *Moody's Investors Service* agreed largely with this prediction. "A move to more regional supply chains, as already is the case in the auto and electronics sectors, could accelerate the shift to domestic production of critical goods, such as pharmaceuticals and food," Moody's said. "The crisis has also laid bare the vulnerabilities of just-in-time supply chain management and could prompt companies to consider moving supply chains closer to their final markets and building redundancies. Data flows and trade in digital services may accelerate as more consumption and work shift online."

Writing in The Hill in April 2022, former US Under Secretary of State for Economic, Business, and Agricultural Affairs Robert D. Hormats stated that while exports remain important, the primary focus for many governments and companies around the world has changed: "Now they are ensuring supply reliability, building reserve stockpiles of key items, attempting to predict and plan for supply disruptions, and diversifying procurement through sourcing in many countries, including a greater emphasis on localization or regionalization, or what some refer to as 'friend-shoring,' as opposed to relying on adversaries."



Automation/Digitization

According to Cordon and Buatois, the struggle to fulfill high demand for ventilators at the height of the pandemic laid bare a lack of preparedness in the supply chain sector to meet a sudden surge of orders. They attribute this to a lack of optimization within the industry, which was behind the failure to anticipate or forecast demand.

The adaptability required to respond to crises, they said, entails optimization through the use of advanced “visibility”, where both suppliers and end-users can see real-time production and shipment status. Powered by robotic process automation to more advanced machine learning and artificial intelligence, Cordon and Buatois envision these “dashboards” as refreshing every 20 minutes to provide a real-time overview of the entire supply chain.

In short, the supply chain industry should continue to leverage innovative platforms and digital technologies to increase resilience, while at the same time producing more consistent products at lower prices.

“Digital transformation demands strategic infrastructure modernization,” according to Ashwani Narang, Vice President and Country Head, Intelligent Spend Group, SAP Indian Subcontinent, writing for BloombergQuint in April 2022. “In that pursuit, cloud-based applications and AI-enabled automation are important contributors. Technological advancements in the fields of AI/ML, Big Data and analytics, RPA, and IoT will enable intelligent procurement.”

Autonomation

Per Cordon and Buatois, as companies emerge from the immediate effects of the COVID-19 crisis, the so-called "human touch" will play an even bigger role in terms of adaptability and resilience. The most ideal mix, they believe, is the Toyota Principle of "autonomation" or automation with a human touch, which combines the power of computers with the unique abilities of the human mind itself.

"Big and unexpected changes in volume render statistical models useless. These assess events such as the pandemic as 'outliers' and, therefore, discard them from the data. Although we need visibility for the people in the supply chain to be able to make decisions, most decisions should be made manually. Ergo, the human factor is key," they wrote. Autonomation as envisioned by Cordon and Buatois involves automating around 80 to 90 percent of the system but allowing a 10 to 20 percent opportunity for human expertise to improve system operation, underscoring the role of manual labor as "a key asset of adaptation that plays a fundamental part of a crisis response program."

Challenges and Opportunities

At a recent forum on the global supply chain, Usha Chandnee Dwarka-Canabady, the incoming chair of the Committee on Trade and Development of the World Trade Organization (WTO) said that ongoing disruptions in the supply chain are now no longer just "shocks in the system… but the new normal." The WTO stressed that to thrive in the new commercial landscape, businesses should accept disruption as permanent and build supply chains that can withstand various challenges.

Three of the major challenges that affect the sourcing community are: dependence on distant suppliers or a lack of diversification of sources; raw material supply volatility; and security threats.

However, in the face of these challenges, industry analysts, academe and multilateral trade organizations have also lined clear opportunities that can be taken to enable the evolution of the supply chain into one more adapted to the changed sourcing environment and resilient to future shocks.

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Dependence on distant suppliers

Product shortages and supply chain disruptions that occurred during the COVID-19 pandemic exposed the dependence of buyers on distant suppliers.

As a *Washington Post* report observed, "The disruption exposed deep interconnections in many supply chains, and just how dependent some sectors like the auto industry were on a few semiconductor factories in Taiwan, or the pharmaceutical sector on Chinese active pharmaceutical ingredients and fine chemical imports."

This challenge was not solely due to the pandemic, however. The dependence on distant suppliers was the result of the shift of manufacturing almost everything – fashion apparel, toys, pharmaceuticals, computer and telecommunications products, cars, and more – to relatively low-cost but far-flung areas. This shift had begun in the 1970s, with manufacturing in developed countries moving to developing countries, particularly in Asia where labor costs and other inputs are lower.

Build resilience: Regional diversification- and strategic investment

To address the challenge of dependence on distant suppliers as well as the vulnerability of supply links to geopolitical stresses, governments and companies are aiming to build resilience. This comes in various forms.

One form is reshoring or bringing back home some manufacturing that had been previously offshored to save on labor costs. However, this poses the challenge of higher labor costs on home shore.

But another form is regionalization, where manufacturing is still offshored but to countries or areas closer to home – another term for it is "nearshoring." The key is to choose areas that still offer relatively lower costs and as a result will still have a positive effect on profit margins.

For instance, a country like the US may consider Mexico as a regional alternative to countries in Asia; and countries in Western Europe may look to Eastern European or North African states.

Regional alternatives offer the benefit of lesser distance and time to market.

Another way to build resilience amid disruptions in a supply chain is by shrinking it through strategic investment.

"Smaller chains, smaller risk," is how the World Trade Organization (WTO) summed up the logic of the approach in a recent Global Supply Chain forum.

An example of such strategic investment is Samsung US' plan to build a $17 billion semiconductor fabrication facility in Taylor, Texas as a way of mitigating chip shortages that were particularly felt during the pandemic.

Raw material supply volatility

Extended delivery times and lower availability of raw materials, not to mention their skyrocketing prices are among the major challenges for the supply chain.

In 2021, in an Inverto survey of procurement and supply chain leaders in Europe, 90 percent of respondents said that raw material prices had "risen noticeably" since the pandemic; 45 percent of those surveyed also said that their companies had been "strongly affected" by changed or lower supply of materials.

Among the raw materials that were mentioned by respondents in the Inverto study that are at risk of being in short supply as well as of being high-priced are: aluminum; plastics; ferrous metals and steel; and wood, paper, and cellulose.

Push sustainability: Circular supply chains

In seeming answer to the challenge of raw material availability, one emerging trend is that of the circular supply chain replacing the linear one. Circular supply chains are those where manufacturers refurbish discarded products for resale or where they break down products to turn them into raw materials.

In the Inverto study, recycling and reducing usage were among measures that respondents said were appropriate to take to better manage raw materials.

Circular supply chains present the opportunity within the sourcing community to push the sustainability agenda as companies create less waste, reduce their negative environmental impact, and satisfy a growing demand among consumers for more products that are environmentally friendly.

An example of the move toward more sustainable sourcing is the use of aluminum and copper scraps for industrial use.

Security threats

The supply chain is also vulnerable to a range of security threats ranging from physical to cyber-attacks. The UK government, through its Centre for the Protection of National Infrastructure (CPNI) and Department for International Trade, in fact issued guidance recently which bares security threats to the supply chain and urges members of the community to be aware of the types of attacks, especially within the context of outsourced supply.

The CPNI lists six varieties of threats:

- **Physical** – attacks made on a company's assets within a supplier's site or during transport;
- **Cyber** – those made on a supplier's IT systems to gain access to a company's information or systems;
- **Insider** – those made by supplier's employees or subcontractors to gain access to a company's assets or information;
- **Geographical** – a foreign state may access a company's information to the location of a supplier's business or operations;
- **Hostile ownership** – foreign ownership or control over parts of the supply chain;
- **Technology** – dependencies on systems with vulnerabilities.

To address security threats, the UK's CPNI urges the sourcing community to build security in procurement. This can be done by adopting a "security culture" within an organization so that it has a system as well as procedures in place to assess threats, determine potential impacts of threats, develop due diligence practices including those necessary for selecting suppliers, and identify mitigating measures against threats.

Speed up digitalization

Supply chain disruptions in the last two years also made it more evident that legacy systems may no longer be sufficient for the current procurement context.

This provides an opportunity to accelerate digitalization to ensure better connection among parties in the supply chain and so that they can all be nimble enough to decide and act in the face of risks.

Investments in digital solutions are among the improvement points that are being advocated by the WTO forum. Among these solutions are artificial intelligence (AI), robotics, and blockchain.

AI and machine learning predictive analytics can be used to anticipate issues that will cause breakdowns or bottlenecks in the supply chain. In addition, AI and predictive analytics can greatly improve decision-making among supply chain users.

Robotics can be leveraged both in manufacturing as well as in warehouse management and logistics. A recent Gartner report stated that labor constraints, including availability and rising wage rates, are already compelling companies to invest in cyber-physical systems. With the use of smart robots, the human workforce can be supplemented and more processes can be automated for greater productivity.

Blockchain can help make transactions in the supply chain more transparent, error-free, and more efficient compared with legacy enterprise resource planning (ERP) systems.

“Given today’s volatile and disruptive environment, supply chain organizations must become more flexible, and the solution is digitalization,” stated Dwight Klappich, VP analyst at Gartner.

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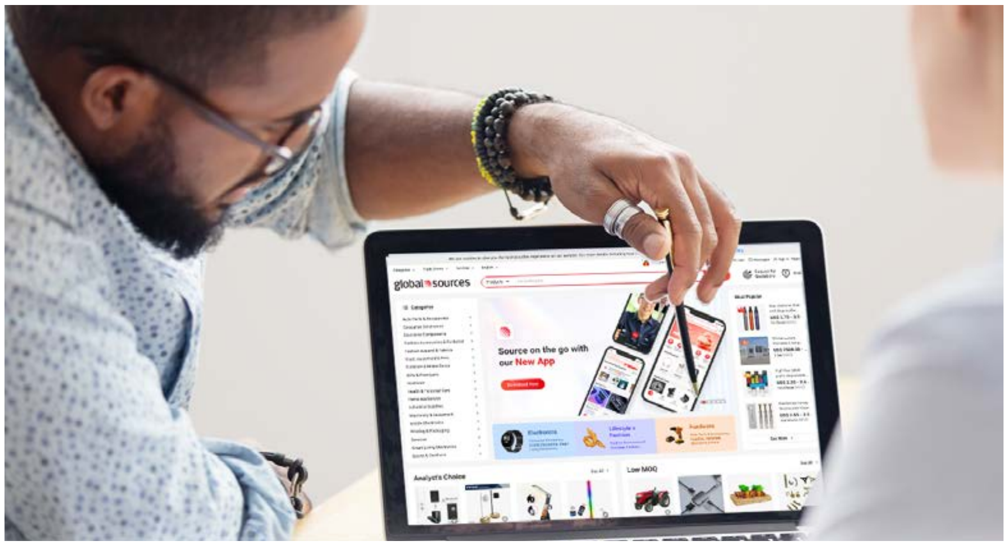

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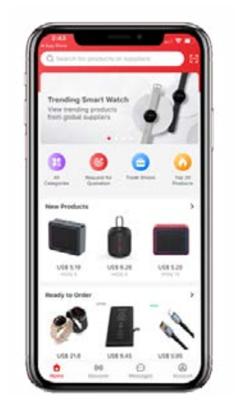

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